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CREDIT MANAGEMENT

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PREFACE

This work sets forth the details of credit mechanisms and credit practice in their relation to the fundamental conceptions of business organization and management.

Credit goes to the root of every business, every profession, every political body. The huge annual losses on credit extensions offer ample proof of the need of better practices in this vital function of modern business. As these losses are ultimately borne by the consumer through price-loading, the subject becomes an economic problem of prime importance. No one can count himself fully equipped for the business and professional world who has not a thorough knowledge of the guiding rules and principles in the extension of credit and the proper redemption of credit through prompt payment of accounts. On the other hand, the man who successfully manages credits and collections gets a breadth of business knowledge that equips him for the very highest positions.

Largely, however, because of the recent and rapid developments in the credit field, the principles and practice worked out by successful credit managers have not as yet been organized in a form which is available to the learner. Too often, when the man who has built up the department is promoted, his successor must in his turn pass through a long and often painful process of apprenticeship. This volume seeks to give the young man preparing for credit work the guidance he needs. The material it contains is the outgrowth of actual experience in the management of a credit department. The organization is the result of experience in handling college classes in the subject. Beginning with the social concept of credit the discussion is narrowed, first, to the relationship of credit to other

business activities and functions; then to the more intimate study of the relations of the credit department to the business unit; and finally to the details of departmental operation.

It is the belief of the authors that the presentation here given will be of value not only to the future credit man but to all young men who contemplate having a business of their own, and particularly to all students in schools of business administration. To aid the student to visualize more clearly the principles and procedure explained, the text is supplemented with a number of practice problems, taken from the credit files of business houses throughout the country. The aim has been to set up these problems in a form which will not puzzle the student but come within his natural achievement in connection with careful study of the text.

Grateful acknowledgment is made to the officers of the National Association of Credit Men and the officers and members of the Los Angeles and Philadelphia Credit Men's Associations, whose courtesy and interest furnished inspiration as well as content material; and to Messrs. A. F. Stepan of the Western Wholesale Drug Company; C. M. Rude, Assistant Vice-President of the Citizens National Bank of Los Angeles; Ralph E. Sperry, Credit Manager of the Security Trust and Savings Bank; Ralph Mathison, of Burr, Conrad and Broom, commercial paper brokers; and E. V. Ryan, of the National City Company, Philadelphia. Sincere appreciation is expressed also for assistance and inspiration on the part of many business and professional associates.

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CREDIT MANAGEMENT

Part I.—Basic Considerations

CHAPTER I

RELATIONS OF CREDIT TO THE ECONOMIC ORDER

Credit Defined.—What is credit? The world of today is organized on a basis which, in the majority of cases, makes it undesirable for one person to render a return in kind or money at the time the first transfer of value is made. Credit in the business world refers to that which is accepted in lieu of goods or money. One person believes that another will pay in the future. The business success and the economic welfare of a community depend not alone upon the production of great quantities of cotton, live stock or grain, or even upon the skillful organization of productive factories or commercial enterprises, but also upon the intelligent creation of that more or less intangible relationship known as credit and upon the wise direction of those mutual and cooperative activities which make it possible to coordinate financial needs with financial resources.

From the point of view of the credit manager of an enterprise, the person who acts as the executive in charge of the opening and closing of credit relationships, or, as he calls them, credit accounts, credit is not necessarily opposite in character to the cash itself which comes over the counter. Much of so called cash is credit currency, representing the credit of nations expressed in currency. One might even follow this

analogy to a point where the credit department would be considered the mint of a house busily engaged in turning out credit specie in the shape of open book accounts and other forms of credit, back of which is the reserve of the credit seeker's assets.

Various definitions of credit as used in business have been given. Joseph French Johnson has said, "Credit is the power to obtain goods or services by giving a promise to pay money or goods on demand or at a specified date in the future." [1] Alexander Wall gives a longer definition, "Credit is the power to secure the present transfer of the ownership of wealth expressed or measured in dollars or other monetary standard, by a promise of the buyer to pay an equivalent at a future time, based on the confidence of the seller in the ability and willingness of the buyer to meet such obligations promptly." [2] Stanley F. Brewster calls credit a "Process whereby the use of capital is transferred from one party to another, measured in amount by the recipient's power to borrow on the one hand, and the confidence reposed in his paying propensities on the other." [3] J. H. Tregoe, Secretary-Treasurer of the National Association of Credit Men and a business economist of note, has looked at credit from another point of view, preferring to see in it a power, and to consider this power as the substitute for cash in a credit transaction. Thus the buyer gives credit instead of cash and the seller agrees to accept this power called credit in lieu of a cash payment, expecting to return the power called credit when payment is made.

The virtue of a consideration of a number of definitions lies in the fact that we come to appreciate the various angles of the subject and the reader can now formulate one which covers the field involved in this study. Credit may be said to refer to that relationship which comes into existence when one

[1] Johnson, Joseph F., *Money and Currency*, p. 9.
[2] Wall, Alexander, *Analytical Credits*, p. 7.
[3] Brewster, Stanley F., *Legal Aspects of Credit*, p. 4.

of the two exchanges in an exchange transaction is deferred, the basis of that relationship being such that there is confidence in the deferment.

The Field of Credit Economics.—Among all men where confidence prevails and within those geographical limits where the relations of men are such that one trusts the other to pay in the future, there will you find the credit relation existing.

Professor Richard T. Ely defines Economics as "the science which treats of those social phenomena that are due to the wealth-getting and wealth-using activities of man." [4] This is another way of saying that it is a study of man in his efforts to create desirable goods which he can exchange for another kind of goods to satisfy his varied wants. The exchange process is the one which gives rise to credit transactions and so the study of credit economics includes a study of those economic principles which tend to strengthen business judgment in relation to all those economic processes arising out of the exchange relation.

Of the four main categories of the subject of economics: Production, Consumption, Exchange, and Distribution, the third or Exchange is the one principally involved, though all the others are closely related. Business is said to embrace the forces that create economic goods, transport them from place to place, distribute them, and increase them, just as in the story of the ten talents. The credit business involves any postponement on one side of the exchange, and all activities forming a part of that transaction.

Credit itself is to be distinguished from the forms which arise out of credit transactions. To know the legal implications of the notes, checks, and other records, does not necessarily mean that the principles underlying the operations involved, are also known. This point was emphasized by J. Laurence

[4] Ely, Richard T., *Outlines of Economics*, p. 4.

Laughlin, who said, "Economic and legal conceptions should be carefully kept apart. The actual transfer of goods is the essential economic part of the credit operation; the promissory notes, drafts, bills of exchange, book entries, and the like are merely the evidence of the credit transactions which have been used to facilitate, in a greater or lesser degree, repayment, and they differ from each other greatly in business convenience and legal force." [5]

The Credit Executive.—In modern business enterprises all questions involving credit transactions are settled under the direction of the head of the credit department, known as the credit manager. The credit manager thus finds himself in the center of the economic stage with questions of production, consumption, exchange, and distribution before him. Though technically he is held responsible only for those situations arising in the field of exchange, yet when the success or failure of a business enterprise is analyzed, he finds that his decisions on credits have permeated all departments of the business and have involved all fields of economics. The factors of production did or did not operate on a one hundred per cent efficiency basis depending on whether or not the credit manager made the proper decision. As the various factors of production clamor for their share of the product, the public is happy or discontented depending upon whether or not there is confidence abroad in the justice of the decisions of the grantors of credit. Rent, interest, wages and profits are but the names of the various portions of the total product created by human activity. The creation of the general income is facilitated or hindered, as the case may be, by credit policy. The credit man who sells to the ultimate consumer on a credit basis, finds himself the center of an activity which presupposes the enjoyment of the goods before payment is made.

[5] Laughlin, J. Laurence, *Principles of Money*, p. 75.

Origin and Development of Credit.—The definitions in the first paragraphs indicate in some measure the beginnings of credit. Early exchanges were carried on with barter as an intermediary. Cash transactions imply that two exchanges of wealth take place at one time. The credit transaction implies that one exchange has been deferred.

It is easy to picture the first instances of credit when one man shared with his neighbor the results of the day's hunt, with the understanding that repayment was to be made sometime in the future. A study of the development of law indicates the changes in credit transactions. The Pandects, published by Justinian in the early part of the sixth century, confirmed in the Basilica, the reformed code promulgated by the Basilian dynasty in the tenth century, indicate the growth of credit as a business force.

The Relation of Credit to Wealth.—If we accept economic value as meaning exchange value, and credit is given in exchange for goods, it seems at first that value has been created, but this credit on the basis of which an exchange has taken place is only representative of value. We all know that as the margin of economic value becomes less and less, a credit arising out of that economic value becomes more and more undesirable. In a way, credit is a measure of wealth. At the moment credit has been received no more wealth has been created though the facilities for the creation of such wealth may have been greatly increased. The idea that credit is wealth has been responsible for many mistakes of business judgment and credits have been pyramided one upon the other until the thin foundation of real value gave way and liquidation demands revealed the difference between real value and representative value.

This conception was well emphasized, though the statement must be qualified, by a leading economist, John Stuart Mill, who said that "Credit has a great, but not, as many people

seem to suppose, a magical power. It cannot make something out of nothing. How often is an extension of credit talked of as an equivalent to a creation of capital, or, as if credit actually were capital. It seems strange that there should be any need to point out that, credit being only permission to use the capital of another person, the means of production cannot be increased by it, but only transferred; that is, the borrower's means of production are increased by the credit given him, that of the lender are correspondingly diminished, as the same capital cannot be used as such, both by the owner, and also the person to whom it is lent." [6]

It must be remembered, however, that while the means of production which pass from one person to the other in a credit transaction remain the same in the hands of the debtor as in the hands of the creditor, yet the possibility of greater productivity through the use by one rather than by the other furnishes the motive for the exchange. The fact that credit is not wealth has been emphasized by comparing credit to the positive and negative poles of a battery. For every debit there is a credit. Neither the positive pole nor the negative would be effective alone. It is the relationship between them which secures results. Credit is not wealth. It is the relationship existing between buyer and seller which proves to be desirable. The positive and negative poles are not valuable in themselves. It is the relationship between them which is sought and this relationship makes greater satisfaction of human wants possible.[7]

Services of Credit in the Modern Economic System.—There is no need to go into detail as to the percentage of credit business and cash business. It is sufficient to say that probably 85% of all retail and wholesale business is done on credit. The

[6] Mill, John Stuart, *Principles of Political Economy*, p. 309.

[7] Adapted from a comparison made by Roland Young, Credit Manager, Ventura Refining Company.

amount varies in various communities and under differing conditions, being affected by (1) the need for a medium of exchange, (2) the degree of certainty of being able to realize on the obligation of the debtor, (3) the objective ability to pay as revealed by the presence or lack of facilities for quick and accurate transmission of the facts. These involve both moral and legal confidence. Every step in civilization has demanded more in the nature of credit service and at the same time has made possible an increase in the number and scope of credit transactions.

The relationship of credit to capital is especially important. "It is as an instrument for the transfer of capital that credit is most useful to mankind. By capital, the economist means all those forms of wealth—all those goods, such as tools, machinery, raw materials, and food stuffs—which men use in the production of new wealth. These often belong to men who have neither ability nor desire to utilize them, and would go to waste or lie idle if our modern credit system had not been developed. This enables men of brains, energy, and skill, whom economists call entrepreneurs (*i.e.,* men who undertake enterprises) to get possession of a country's capital and devote it to productive uses."[8]

Thus, on the one hand, we find the process of production being lengthened by the introduction of more highly capitalistic methods and the greater extension of territory over which commerce is carried. On the other hand, credit was found increasingly necessary, for it proved to be of advantage to the individual and to the nation, and with every step in civilization came an increased number of credit transactions. To the individual, loans for consumption purposes are often desirable and necessary. Credit for a college student makes an education possible. A monthly charge account keeps food and clothing available until the pay check comes in. Thirty days'

[8] Johnson, Joseph F., *Money and Currency,* p. 36.

time for the retailer enables the use of sales receipts for payments on purchases and so the man of small capital finds it possible to go into business.

A man who is to inherit a million dollars at fifty years of age finds credit helpful in securing earlier enjoyment of his riches. Credit of this character benefits two classes of people, the borrowers, who might otherwise have no incomes now, and the lenders, who might otherwise expect to have no incomes, or a smaller income, in the future. Production requires the factors of production, land, labor, capital and management. Few men have all of these. A man with management ability may borrow a portion or even all of the others and thus he can make a success. The fact that he makes a success implies that he has created something of economic value in an efficient way. Society is the richer and the nation has prospered. Land, capital and human resources then find their way into the control of the more efficient users because credit enables the individual to overcome the handicap of a lack of capital.

Mention of the importance of credit as a part of the medium of exchange must not be omitted, though a complete discussion of that function is not to be included here. One has only to compare the total of bank clearings of the United States with the total amount of actual money in circulation to see how insignificant is the amount of money. In one week ending July 28, 1923, the average daily bank clearings were $1,077,-783,042 and the money in circulation on August 1, 1923, was $1,490,391,084. Bank clearings, of course, represent only one part of the total of credit transactions, yet the daily bank clearings were almost as great as the amount of money.

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CHAPTER II

TYPES OF CREDIT

The Credit Chain and Production Processes.—We have seen that credit enters into most of the many transactions taking place in the production and consumption of goods. From the point of original production to the point of ultimate consumption, a large group of people participate in the various transfers involved. Many of these participations are of a credit character. For instance, take the case of wheat from its production to its point of consumption as flour. The farmer buys machinery, and promises to pay when the wheat is harvested. He sells the wheat to a broker and receives a promise of payment when the wheat is milled. In some cases the broker may have advanced money to the farmer to grow his crops. The broker in turn delivers the wheat to the miller and receives a promise to pay. The miller delivers the flour to the wholesaler; the wholesaler delivers it to the retailer; the retailer sells it to the ultimate consumer, who, like as not, "charges" it. In each case the vendor received only a promise to pay, usually in the form of a promissory note. In the meantime the farmer needs his money—the credit chain is strained. At this point the banks and financing companies step in, and by lending money on the notes, they "carry" the financial burden until the money is received from the sale of the flour and passed back along the chain. This strain may occur at different points along the credit chain. The broker finds that he is short of cash at certain intervals and could do more business if for a time he had a greater amount of capital available. The bank loans him the money to carry him over the peak of his activity. The manufacturer finds

that he cannot always control his purchases and sales so as to conform to available working capital, and so, when new supplies of raw material come in or when he is waiting for payment on seasonal goods, banks grant him credit. The wholesaler and retailer are both affected by much the same conditions and find in the bank an institution which draws its funds from one group of individuals at the time of surplus and loans to others at time of need. Not all the businesses within the radius of a bank's activities need funds at the same

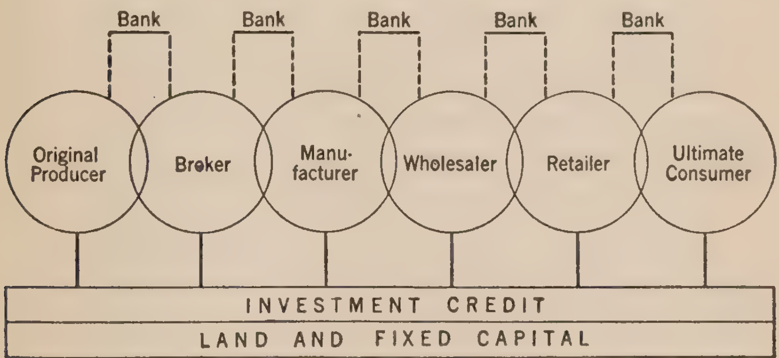

Figure 1. The Credit Chain

time. The balances of some increase while those of others are low. The bank becomes a reservoir of credit available for the time of shortage.

In order to make this more plain a rough pictograph of the situation involved has been drawn. It is not intended as an exact presentation in detail but as an approximate indication of general principles underlying the respective relations. It also serves to call attention to the close relation between credit and the economic organization of today.

Retail Credit.—When the individual purchases something for himself in a retail store and asks permission to take the

article with him or have it delivered at his home on the basis of his promise to pay, we say there has been an extension of retail credit. In all cases the term retail credit refers to credit relations where one party is the ultimate consumer, whose wants are directly satisfied thereby. It is generally represented by records on the books of the retailer who charges his customer until payment is made. In the retail credit chain, the ultimate consumer is found functioning as the last link. Ultimate purchasing power of the reliable customer gives the basis for retail credit.

It is also to be remembered that upon the functioning of ultimate purchasing power depends the payments necessary to complete all the transactions to bring the goods from the original producer. When the consumer pays, the retailer can pay, and then the wholesaler can meet his obligations to the manufacturer. This is the one kind of credit justification which has been questioned. Merchandising with and without credit has been successful and the retailer must study the conditions surrounding his own business before deciding that a certain credit policy is correct. Local conditions must give the answer, together with a consideration of the type of organization of the retailer.

Commercial or Mercantile Credit.—When the retailer replenishes his stock of goods from the jobber or wholesaler we speak of any credit relations arising as being mercantile in character. Likewise other links in the chain of production processes, such as brokers, manufacturers, jobbers and original producers often make use of mercantile credit and thus we speak of the various links in the credit chain. The farmer, miner, or cattle raiser often needs money to grow a crop, get the product from the mine, or feed young cattle, and so many times he gets a temporary loan from the broker or manufacturer. This he often does through the aid of his

own banker. The manufacturer often finds himself in need of funds as well as under the necessity of granting extensions of time to wholesalers and so he often meets the situation by a factoring agreement, particularly in some lines of trade. Thus any credit extended, by those engaged in one process of production, to another person with the idea in mind that payment is ultimately to be made through the sale of the commodity itself, is mercantile in character and may be described as self-liquidating.

In the ordinary channels of trade there is thus set up an automatic system of payment which, if abuses are not allowed to creep in, tends to a healthy condition of business. It is not intended that commercial or mercantile credit is to be extended for the purchase of fixed capital such as buildings or equipment, but rather is it to allow payment for the "stock in trade" which is to be sold in the regular run of business. It is presumed that the time of this credit is based on the time of turnover of goods and not upon the life of the goods as may often be the case in connection with investment credit. This has given rise to the customary limitation of commercial credit loans of banks to thirty, sixty, or ninety days. Commercial credit loans are ordinarily short time loans, and investment credit loans are ordinarily long time loans.

Investment Credit.—Up to this point we have dealt with only two kinds of credit, so far as fundamental nature is concerned,—commercial and personal. There is a third kind of credit the nature of which is widely different. Many serious mistakes in credit work have been made because of a failure to recognize existing differences. Investment credit refers to that which is used for the purchase of fixed assets, such as land, buildings, machinery, etc. Its distinctive characteristic lies in the principle underlying the plan for its repayment. It is not intended that the assets themselves are to be sold and

the proceeds used for payment, for it is not self-liquidating as is a commercial loan, but through the use of these assets in a productive way profits are to accrue and gradually the debt is to be wiped out.

To be more concrete, it is easy to see that the farmer might need a new barn; the miner, some hoisting machinery; the cattle raiser, some wire fencing; the manufacturer, some new machinery; the wholesaler, or jobber, a new warehouse; or the retailer, a new delivery truck. None of these things could properly be the subject of commercial credit but would properly be the subject of investment credit. That is to say, it is not intended that these fixed assets are to be sold and the proceeds used for payment but that through their use more production is to take place, and profits are to be made which will pay for the investment at a later date. The credit manager must always be on his guard to see that when he extends commercial credit, it is used for the purpose intended and that the funds made available by such extension of credit are not diverted into fixed assets.

This treatise will discuss primarily commercial or mercantile credit with attention given to bank credit and retail credit only in connection with those aspects which differentiate them from the former.

Bank Credit.—This deserves special treatment only because great financial institutions have been set up to deal in mercantile or commercial credit and make it available to a larger number of producers. The credit is still commercial in character though the channels through which it operates are different. The diagram indicates the position of the bank. If at any time the various links in the credit chain find the strain too great for their own resources, they may, with the proper showing, receive aid from a banking institution which has gathered together the surplus resources of other firms and now

stands ready to distribute them where needed. The bank takes up the strain of the credit relation. It functions in connection with every link of the chain.

Banks not only extend credit but they get credit from other institutions. In order to meet the needs of their customers they must make use of banking credit. Some of the credit is obtained in a manner peculiar to banks. In connection with their loans they create obligations, transferable in nature, in the form of bank notes or deposits. Credit extension is perhaps the chief function of a bank. The commercial bank specializes in short term loans which are self-liquidating in character.

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CHAPTER III

THE BASES OF CREDIT

Analysis of the Credit Risk.—A real understanding of credit involves far more than a mere definition. It presupposes a knowledge of the bases upon which credit is founded. In business we hear various terms used in connection with the creation of a credit account, such as passing credit, granting credit, approving credit, extending credit, etc. It makes little difference what particular term is used. The bases for the extension or creation of credit constitute the really important factors.

To lessen the amount of credit illiteracy is one of the tasks of the credit man. Chapter I on the "Relations of Credit to the Economic Order" has indicated the fundamental relationship of credit to the economic organization through which production, consumption, exchange, and distribution function. The present day business man finds himself a part of an automatic mechanism which is given up to buying and selling. In the deferment of payment on the part of the buyer, all the questions relating to credit which an outline of the subject has indicated are raised.

The fundamental bases upon which this deferment of payment rests are the bases upon which credit transactions can take place. Credit granting today does not depend upon the caprice or estimate of any one individual. No one base is capable of unlimited expansion. There are fundamental considerations which classify credit transactions as legitimate or illegitimate, depending upon the results obtained after using the proper "measuring stick." The problem involved in the proper classification of legitimate and illegitimate credit trans-

actions is now recognized as one of the more important factors in the hectic fluctuations of prosperity and serious periodic depressions common to economic history.

In the development of credit analyses and in the writing of credit literature it has long been the custom to think of the three C's of credit, and there is probably no better way to secure for the credit student a clear understanding of the foundations upon which a sound credit structure can be reared than to discuss character, capacity and capital. There is a fourth "C" of credit, particularly important to the banker—collateral, which may be called "the second line of defense."

Material and Moral Bases of Credit.—These bases of credit may be said to be of two kinds—moral and material. The moral side concerns "character," and there are certain questions in connection with this which must be satisfactorily answered before credit is granted. Who *is* the credit seeker? How does he pay his bills? In other words, is the buyer or borrower *willing* to pay?

"Capacity" and "capital" are the material bases of credit granting. Has the buyer or borrower the *ability* to pay when the time comes? What *has* he now? How much capital? What are his assets and liabilities?

It is evident that the problem arises out of the question of payment at a later date. Favorable response to these questions establishes confidence. If every credit manager could get a definite answer to each of these questions, little difficulty would be encountered, but there are few clear-cut answers to any business proposition. This results in serious problems for the credit grantor.

Character and the Moral Risk.—The question of arranging the four C's of credit in the order of their importance always divides credit men into two or more groups. Many

rate capacity and capital as high as character or even higher. On the other hand, there is one point upon which we all agree and that is that no one wishes to do business with a "crook." In that sense, at least, character is the most important. J. P. Morgan's famous maxim, which has almost become the basis for an axiom for credit granting in America, has done much to crystallize this sentiment. Though it must be said that while he loaned a million dollars to the man who had not a cent in the world, he also knew at the time that the man possessed capacity.

Character forms so important a part of the subject of credit and collections that it is impossible to place too much emphasis upon it. Doubtless, every one who applies for credit believes he has character in superabundance, but this is a question upon which the credit man must pass judgment. Since character has to do with the moral risk, it is oftentimes intangible in comparison with capacity and capital. All of those characteristics which we call attributes of personality are difficult to classify.

As an index of the applicant's character we like to know something about his habits of life and the relation between his personal income and his personal expenditure. We are interested in his family connections; his wife and her habits, desires and social ambitions. We like to know the proportion of time spent in productive activities and pleasure seeking, and whether that time which is devoted to pleasure seeking tends to weaken or strengthen capacity for work. We are concerned with his methods of doing business, his truthfulness, punctuality, respect for business engagements, attitude toward the ethical standards of his line of business, and his attitude toward community enterprises.

Capacity and the Intelligence Factor.—It has been pointed out that character is essential to the granting of credit—

character that begets confidence in the buyer's willingness to pay his obligations at some future date. But this confidence must extend farther than the mere belief that the borrower will, on his implied or expressed promise, meet his obligations. Honest men are found in the poorhouse. Honest men are included among those who, at the age of 65, are dependent upon relatives. In the long run, character without capacity never serves the community and seldom serves the individual. Capacity to do something which is of service to the community is essential to success. Therefore, it is the duty of those who grant, extend or create credit to ascertain enough facts concerning the ability of the credit seeker to make confidence in his character concrete and sure.

Many men of incompetence, who are misfits in business, apply for the extension of credit—men who cannot keep a check account straight, who are illiterate, who have not the slightest conception of accounting methods, or of the commercial laws entering into transactions. The result of their inability is partially evidenced by the annual commercial losses through business failures.

When these losses are surveyed, the questions often asked are, (1) "Why?" (2) "How can this enormous loss be stopped?" The credit man can play an important part in the answer to that second question, for it is upon the credit man that the granting of credit depends. When he makes his investigation, he must be sure that business ability is present, and that the credit seeker has the intelligence to apply himself in such a way that society will pay him for what he does.

The ability of the credit applicant should be both financial and technical. His financial ability may be measured by his standing at his bank, his buying and selling habits, and the number of attractive discounts taken. From the technical standpoint, the skill or lack of skill with which his business is carried on, the care with which questions of competition have

been met and answered, and the opinion of the community in which his business is located, are indices of the borrower's capacity.

The wide spread movement of popular education, the tremendous popularity of college education, the immeasurable influence of adult education in all of our large population centers, and the economy with which the best information can now be secured in magazines and periodicals, all tend to raise the level of intelligence throughout the country, reflecting in a favorable way upon questions of credit and the problems connected therewith.

Capital and the Financial Record.—By the term "capital" is meant produced goods used in the further production of economic goods. Capital goods include buildings, machinery, tools, and all those implements in our modern life which have been produced, not for consumption, but for the production of other economic goods. These are the things which make our capitalistic form of production possible. The business man, when he speaks of his "capital," usually has reference, not to the capital goods themselves, but to the money which the goods represent. When the credit manager investigates a business man's capital, he is directly interested in all those economic resources through the use of which the applicant can create wealth to pay his bills.

The credit manager wants to know how much the man responsible for the success of the business has at stake. He also wants to know whether or not the capital that is indicated is large enough for the business which he is attempting to conduct, and, in the case of a particular obligation, the credit manager wants to be sure that at the time the obligation comes due, funds will be available in proper form to meet it. He wants to know whether the capital was inherited, whether it is money

made in a previous period in some disreputable line of activity, or whether it is money earned by hard, conscientious work.

The facts concerning capital as one of the bases upon which credit is to be granted are found in the accounts,—generally in the form of the profit and loss statement and the financial statement. These records are analyzed by the credit manager and deductions drawn which lead to the conclusions upon which the credit judgment is based. Because this is such a tangible method, some credit men place greater reliance upon it in the granting of credit than upon either character or capacity. Others think that as a rule, capital presupposes character and capacity. Further consideration will be given later on to the financial record.

Collateral, the Second Line of Defense.—Collateral has been included as one of the bases for credit because, in so large a proportion of our credit transactions, collateral is used as security for the payment of the loan at the time due. Banks particularly make a large proportion of their loans on the basis of collateral. This arises from the fact that banks have a peculiar relationship to the community in which they are organized in that they must keep liquid reserves large enough for all current needs.

To loan on collateral is to grant the use of money for a period of time, asking the borrower to give as security listed or unlisted bonds and stocks, bills of lading, warehouse receipts or trust receipts representing merchandise, or real estate. As a basis for credit, collateral, of course, is naturally satisfactory. If the margin is sufficient to take into consideration market fluctuations, and the collateral itself is sound, the credit manager finds little to disturb him when loans are made on this basis. As a special feature of bank credit a further discussion of this topic will appear later.

External Factors Bearing on the Bases of Credit.—The factors previously discussed may be classified as *internal* in that they refer to those characteristics of good and bad credit risks which are an integral part of the individual or firm asking for credit. There are other influences affecting credit which may also be termed as basic, though they are *external.*

Dr. John Whyte has grouped them under the heading of business movements,[1] and classified them as of two types: (1) regularly recurring seasonal movements, (2) oscillating movements of business as a whole, commonly known as the business cycle. He points out that a knowledge of these two movements is essential to a correct estimate of willingness and ability to pay in the future, in that business is not static, and capital and capacity cannot be evaluated identically in slack and active seasons, to say nothing about periods of depression and prosperity.

Seasonal variations are not difficult to understand, but their significance is often forgotten. Agriculture, in all of its forms, is seasonal. Indirectly, it touches every economic activity in America. However, the severity of the seasonal variations is offset by the fact that the different localities have their periods of seedtime and harvest at varying times throughout the year, and the credit system does not have to carry the strain at any one season.

It must be remembered, however, that in particular cases, this seasonal variation is often marked and each credit risk must take the full brunt of the situation, for certain districts and communities are often dependent on single industries for their support. Arrangements to make pay periods coincide with each other, so that money is coming in at about the time payments ought to be made, both in relation to the nature of the industry and the seasonal characteristics of the particular line, have assisted materially in strengthening the credit risk.

[1] Whyte, John, *Credit Monthly*, March, 1923, p. 15.

The second external movement, that of the business cycle, has a very vital relation to credit. Since the coming of capitalistic production, business has experienced periodic changes in business conditions, shifts from prosperity, through liquidation, adjustment, improvement, to prosperity again. It is not possible to forecast with absolute exactness either the length or intensity of these movements. Business science, however, in the form of statistics, is able to study fundamental data, and so give a definite enough idea of the periods to enable business men to take warning or encouragement, and to know when to expand and when to contract credit and volume of business.

Because the credit man must always think in terms of the future, it is vital to him to know whether six months hence will be a period of prosperity or a period of depression. If payments fall due during prosperity, they are likely to be made, while payments which fall due during depression are likely to be frozen at the time when payment should be made.

So it is evident that the oscillations which constitute the business cycle are of utmost importance to the credit man; and that the *external* bases of credit have a vital part in the granting of credit, equal almost to that of the *internal* bases.

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CHAPTER IV

CREDIT TERMS

Nature of the Business.—In Chapter II we indicated the existing conditions which bring about the substitution of credit transactions for cash transactions in the economic processes of production by means of which the raw materials of nature finally satisfy the wants of the ultimate consumer. There is no more sensitive aspect of credit than that relating to terms. In our definition of credit we found that time was an essential element. The question of credit terms is a question of time. The business efficiency of a community is often measured by the strictness or lack of strictness with which such terms are followed in every-day transactions. Often communities and even large sections of a nation compete in credit terms rather than on a basis of service rendered.

Meaning of Terms.—The terms of the credit relationship involve in general the length of time between purchase and payment, and also specify the methods of payment. As a rule, the time element has two alternatives. A certain length of time—for instance, 60 days—is given until the whole bill is payable. It is usually specified that if the account is settled within a shorter time—for instance, in ten days—a certain percent will be deducted from the total amount of the bill.

The following terms are some of those in common usage, terms with which every business man should be familiar:

(1) ½% 10 days to 4% 10 days. These terms indicate that a discount varying from ½% to 4% will be allowed on the invoice if the account is paid within ten days from date of such invoice.

(2) ½% 10 days to 4% 10 days N 30 to N 120 days. This also means that a discount of ½% to 4% will be given if the account is settled within ten days from date of invoice, but also that the final date of payment, if no discount is desired, will be from 30 to 120 days. It is usual, of course, to allow a larger discount if the invoice is paid at once. For instance, one might quote as follows: 6% 10 days, 5% 30 days. 4% 60 days, 2% 90 days. This indicates clearly that the discount offered decreases as time lapses.

(3) 1% 10 days to 2% 30 days' extra to 60 days' extra may be explained as follows: In certain lines of business it is found advisable to allow 30 or 60 days' extra credit on a shipment of goods. For instance, 1% 10 days 30 extra means that the buyer may deduct 1% from his invoice if it is paid 10 days after the 30 day period, or, at the end of 40 days. By virtue of trade custom, if a merchant pays for the merchandise ten days after day of purchase, he is entitled to an additional discount of 1%. On June 1, A buys $1000 of merchandise from B on the terms 2% 10 days—60 extra. The buyer may discount the invoice 2% if he pays it at the end of 70 days, August 10, but if he pays at the end of 10 days, June 10, he may deduct an additional 1%. Also, it is trade custom to allow the deduction of interest at the rate of 6% per annum from the net amount, (invoice minus discount) if the account is settled at any time between June 11 and August 10. If the account is not settled by the end of the seventy day period, August 10, the purchaser is not legally entitled to any discount but in many instances he would be allowed to deduct the discount if interest at the rate of 6% per annum were added for the additional time. It would appear then that the 2% is more of a mask for the selling price than a discount and that the real discount is the 1% allowed if the bill is paid within 10 days.

In this case "extra" refers only to time, and is not to be confused with the other meaning, namely: "extra" discount.

The following is an example: A wholesaler sells a retailer a certain amount of goods. Later, but previous to settlement, he finds out that the retailer is in financial difficulties. He then goes to him and offers a discount of 1% if the bill is paid at once, thus offering him "extra" discount for the immediate closing of the account.

(4) 2% 10th proximo. In some lines of business where merchants are buying goods every day, it is very inconvenient to pay invoices every day in order to take advantage of the discount. For this reason, many firms quote 2% 10th prox., or e.o.m. (end of month). This signifies that 2% discount will be allowed on the purchase price of a commodity if the account is paid by the tenth of the month following the date of purchase. In this way merchants are allowed to group transactions for an entire month and take the discount on all merchandise bought during that time if the account is paid by the 10th of the month following.

That these terms vary from date to date is shown by the following statement from the Treasurer of the Borden Stove Company, Philadelphia:

> In the archives of the Borden Stove Company was recently found a catalogue of the vintage of 1862 issued by a competitive stove manufacturer. That there has been a marked change in terms of credit in the last fifty-eight years is indicated by the terms set out in the catalogue, as follows:
>
> "All bills under $50. payable January 1 and July 1, without discount.
>
> "All bills under $50. payable January 1 and July 1, without discount at four months, unless otherwise agreed upon.
>
> "All bills bought after July 1st payable one-half January 1st, the balance to be settled for by note at three months.
>
> "Cash Discount five per cent."

(5) C. B. D. means *Cash Before Delivery,* and is the term used for all ordinary cash transactions.

(6) C. O. D. means *Collect on Delivery* or *Cash on De-*

livery. When sales are made to poor risks in a line of business where C. O. D. terms are not customary the credit manager attempts to protect his house from loss by requiring the buyer to pay cash at the time of delivery. Sometimes the buyer refuses to accept the goods unless credit is extended, and then the seller must either acquiesce or pay return charges. If it is the real intention of the seller not to extend credit on C. O. D. terms, he should demand currency or a certified check in payment.

Factors Governing Length of Net Terms.—There are several fundamental factors which determine the length of net terms granted. W. H. Steiner, while acting as Chief of the Division of Analysis in Research of the Federal Reserve Board [1] classified these factors as follows:

(1) The underlying factors, having do do with
  a. Nature of the commodity
  b. Pay-day habits
  c. Geography

(2) The marketing system, whereby the article is brought from producer to final consumer.

(3) General competitive conditions under which the sale takes place.

Nature of the Commodity.—It is evident that the nature of the commodity has a great deal to do with the terms of payment. According to Mr. Steiner [2] four points must be considered in this connection:

(1) Whether the sale involves a large or small amount.

(2) Whether the article is preservable or perishable.

(3) Whether it is standardized or subject to changes in fashion or style.

(4) Whether it is for seasonal or for recurrent use.

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[1] Steiner, W. H., *Mechanism of Commercial Credit,* p. 18.

[2] *Ibid.,* p. 19.

A sale which involves a large amount of money calls for greater discounts and longer terms. The degree of perishability has a great effect on credit terms. This may be illustrated in the case of fresh meats. They are very perishable and must therefore have a quick turnover. Because the commodity cannot be taken back for non-payment, the terms must be short. Standardization may refer either to price or quality. If a product is standard, it is possible to buy it from day to day in smaller amounts. Also, if better known, it needs less display. Orders may be taken, instead of keeping a large stock on hand, from which customers may select All these characteristics tend to make terms shorter. There are some standardized commodities, such as farm implements, where terms are long, but in this case, other factors enter in to influence the length of the terms. In general it may be said that the greater the standardization of a commodity, the shorter the credit terms. The seasonal character of goods also affects the terms of credit. In the cotton producing sections of the South, credit payments are required in relation to the marketing of the crop. The "general store" of the Southern community often "carries" the cotton grower from one season to the next. In general, it may be stated that seasonal commodities require long credit terms.

Pay-day Customs.—Terms of payment must often be adjusted so that they coincide with pay-day. In communities where pay-day comes on the first of the month, or on Saturday night, the length of terms will be shorter than under other conditions where the income is more irregular. Where the business activities are diversified, pay-day does not have a great effect upon terms, but where industry is specialized or localized, terms must be arranged to suit the time when most persons receive their pay.

Geographical Considerations.—Allowances must be made for the time it takes to ship a consignment of goods from one part of the country to another. When merchandise is shipped thousands of miles, as often happens today, a longer time is consumed than when merchandise is shipped a few hundred miles. Naturally, longer terms are granted to the far-away customer. On the other hand, the means of transportation also have their effect on the terms. Because of fast transportation a commodity may reach its destination sooner than another commodity which is shipped a shorter distance, but consumes more time in transit. In such a case the credit terms will depend on the time and not on the distance.

Marketing Problems.—The purchaser of a commodity, assuming that he is a dealer, either buys in such quantity that he has a stock of goods, or buys for immediate sale. His marketing problem depends on the size of the purchase, and the length of time it will take to dispose of the goods. If the goods are to be disposed of at once, the credit terms will be short; if, on the other hand, they constitute a stock to be sold slowly, the terms will be longer.

Where strong competition exists among sellers or buyers, credit terms are affected. If there is competition among the sellers, each one will make concessions to the buyers, in order to get the business, and the terms to buyers will be easier than would otherwise be the case. If, instead of competition, there is organization among the sellers, the terms will be less advantageous to the buyers.

Datings.—Other types of variations in credit terms are common. Among these is that of dating, by means of which an additional period for payment is given. The date of payment is set by an agreement to begin counting time from a certain date. It is an outgrowth of the necessity of making con-

cessions to certain buyers. There are four different types of datings: season datings; deferred datings; datings on shipments to distant territories; and extra datings.

Season datings are those which arise out of the seasonal nature of the business. For instance, wholesalers of dry goods generally take orders and ship goods 30, 60 or 90 days before the season in which the goods are to be sold. The credit terms begin on a set date, such as April 1 or May 1 in the spring, and thus give the retailer an opportunity to get the goods in on his shelves and sell them in the proper season without being called upon to pay for them in advance. It is to be remembered that such credit terms in the dry goods business are quite common. "Season datings most frequently specified are April 1 and October 1, in general for shipments made prior to two months before the dating, thus being February 1 and August 1 for the datings given, after which time the regular 60 days' extra terms are given. Certain houses, however, employ other season datings, in particular May 1 and November 1, for the general line, while several instances of earlier datings, such as February 1 and March 1, and August 1 and September 1, were also noted. Orders bearing the season dating in general carry no further dating, although in certain cases 60 days extra was also given, mainly by houses having the earlier season datings and practically nullifying the same." [3]

Mr. Steiner [4] quotes the following resolution of the Paint and Varnish Credit Club in which the advantages of seasonal dating to the seller are given with a suggestion of some of the difficulties involved:

> Whereas, for a number of years the paint and varnish manufacturers have offered spring datings for orders placed in the fall for shipment during fall and winter months, and
>
> Whereas, this privilege was offered for two reasons:

[3] *Federal Reserve Bulletin*, Vol. 6, p. 800.
[4] Steiner, W. H., *Mechanism of Commercial Credit*, p. 58.

> First. To keep the plants running and the employees on full time during the winter months.
>
> Second. To avoid congestion in the plants during the busy spring months, and
>
> Whereas, this very liberal attitude of the manufacturers has resulted in the abuse of the privilege through the dealers placing a great many small orders, evidently for immediate consumption, with the expectancy of spring datings; therefore it is
>
> *Resolved*, that this practice be stopped and that where it has been customary to grant spring datings, the manufacturers limit the privilege to one complete stock order, to be shipped at the option of the manufacturer after November 1.

By deferred datings is meant those arising when manufacturers take orders for goods and arrange to ship them at a definite date in the future. Thus the dating is set on the date of shipment, and shipment is not to take place until some time in the future though the purchase has been made earlier in the season. It is reported that in the millinery braid industry buyers take advantage of the date of shipment in a way which enables them to get a deferred dating. "Millinery braids were sold to millinery jobbers and hat manufacturers upon terms of 6 per cent 10 days, with datings of April and October 1, but practice as to payments is stated to be very lax. On March 1, 1920, purchasers were advised that the season dating would be eliminated, and terms would be 8 per cent 10th e.o.m. or 6 per cent 10th e.o.m., 60 days extra, but the effect is stated to have been nullified through instructions given by customers to ship goods on January 1, making due dates and discounts 8 per cent February 10, or 6 per cent April 10." [5]

Datings on shipments to distant territories may be illustrated by a practice of manufacturers who ship to the Pacific Coast. They find it desirable to give an extra thirty days, thus recognizing the time required for the transportation of goods. The purchaser is thus able to meet competition on the same

[5] *Federal Reserve Bulletin*, Vol. 6, p. 809.

basis as if he were only a short distance from the source of supply. These terms are often designated as A. O. G. terms, *i.e.*, where the terms are based on date of arrival of goods instead of date of shipment. In some cases the net period is measured from the date of shipment and additional time only given for taking the discount.

Extra datings have arisen out of competitive conditions. The dry goods business illustrates this type. It has been found desirable to extend the net terms 30, 60, or 90 days, though the discount is deductible if settlement is made within the time limit. Strictly, this term seems to be a misnomer. Instead of being an extension of time, this type of dating seems to be a shortening of a period which ran 4, 6, or 8 months.

Discounts.—There are two distinct types of discounts—trade discounts and cash discounts. The trade discount is a method by which a manufacturer may protect a wholesaler or jobber from the retailer. The seller allows the jobber a certain discount which he does not allow the retailer. Trade discount is allowed from the published list or catalogue price. Thus a concern can change its selling price without changing the published price. The invoice cost entered on the books is generally the amount which has been secured after figuring the entire trade discount. For instance, if the list price of an article is $50, less a trade discount of 50%, 20% and 5%, the actual cost to the buyer is $19.

List Price	$50.00
Less 50% Disc.	25.00
	25.00
Less 20% Disc.	5.00
	20.00
Less 5% Disc.	1.00
	$19.00

The cash discount is a deduction from the amount of the bill, given because the bill is paid before due. The cash discount is always more than the interest for the same period would amount to, so all buyers who possibly can, take advantage of it. A short table will show the importance of the discount. 2% 10 days, N 30, amounts to 36% per year.

1% 10 days, net 30 days,	18%	per annum
2% 10 days, net 30 days,	36%	per annum
3% 10 days, net 30 days,	54%	per annum
3% cash, net 30 days,	36%	per annum
5% 10 days, net 30 days,	90%	per annum
8% 10 days, net 30 days,	144%	per annum
2% 10 days, net 60 days,	14.6%	per annum
3% 10 days, net 60 days,	21.9%	per annum
2% 30 days, net 60 days,	24%	per annum
5% 30 days, net 4 months,	20%	per annum
3% 30 days, net 60 days,	36%	per annum

The buyer who finds himself in a superior credit position is always willing and anxious to take the discount. Thus the seller immediately groups all of his customers into two divisions and concludes that one is a strong credit risk and the other a weak credit risk. Consequently he finds it possible to put more of his attention on the poorer credit risks who do not take the discount and should find an opportunity to make his credit work more efficient. However, if it is a premium offered, and to a certain extent the cash discount is a premium though the time and interest elements are also important, the bank finds that its customers are asking for money to discount their bills and the credit responsibility is shifted from the mercantile establishment to the bank. Of course, the mercantile establishment still has a contingent liability on rediscounted paper or direct borrowings.

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CHAPTER V

CREDIT INSTRUMENTS

Necessity of Written Records.—If the business man took part in only a few transactions each day he could remember all the details connected with every contract and still be able to control his business in such a way that at the end of the year he would know just where he stood financially. The present economic system, however, requires a successful business man to be a party to thousands of transactions each day—perhaps each hour. This has demanded a system of records complete in every detail, and this system of records must be created automatically through the very motions necessary to transact the business.

We have indicated that probably 85% of all the business of this country is done on a credit basis. If it is important to keep a record of cash transactions where both transfers of property are made at the same time and, so far as these transfers of wealth are concerned, neither party is waiting for action on the part of the other, it is easy to see how much more important it is that a record of all credit transactions be kept in a way which will eliminate the possibility of dispute.

To use credit effectively it has been necessary to devise numerous written documents which have been called "credit instruments." These documents or writings are the means of giving formal expression to a contract,—in this case a contract involving the transfer of property for value with a second transfer to be made at a future date.

General and Limited Acceptability.—The records representative of the credit transactions are of two general types:

those of general acceptability and those of limited acceptability. Many of the common credit instruments of the day are uniformly accepted by all classes of people at all times at their face value. Examples of these are Federal Reserve notes, greenbacks, National bank notes, silver and gold certificates. They pass from hand to hand and are known as money or currency. They are a very important influence in our economic system. We shall not take the time to discuss them in detail here except to call attention to the fact that they serve the community as a medium of exchange. They are based on a standard of value, and any analysis of the monetary system of the nation or the relationship of the standard of value to our economic organization must reveal full knowledge of their importance. Such a study would also necessarily show the importance of any questions connected therewith as determinants of the general credit standing of the nation and of its various sections.

Such credit as gives rise to instruments of limited acceptability, is the subject in which we are chiefly interested. These instruments may be classified in a variety of different ways but for our purposes we shall discuss them under the following headings; open book accounts, promises to pay, and orders to pay.

Open Book Accounts.—The open book account is the simplest and the most extensively used form of credit. It is the normal method by which mercantile credit transactions are recorded. While the past decade has seen considerable agitation for the substitution of the trade acceptance system for open book accounts, the development of this practice has been slow. The book account is created by opening an account on the books under a customer's name, charging him with the selling price of goods sold. The modern system of book accounts involves the use of debit and credit and is so kept that at any time the

striking of a balance is possible. The following is an example of the open book accounts:

Frank Smith has purchased on September 10, 1923, $300.00 of merchandise from the Graham Manufacturing Company. The Graham Manufacturing Company will then make the following entries: Merchandise Sales will be credited for the amount of the sale, $300.00, and Frank Smith debited with the amount so that the books of the Company will show Frank Smith charged with the amount of the purchase.

MERCHANDISE SALES

		Sept. 10	300 00

FRANK SMITH

Sept. 10	300 00		

The books of Frank Smith will show the transaction as follows: Merchandise Purchases will be debited with $300.00, the amount of the goods purchased, and Graham Manufacturing Company credited with the amount. Smith's books will then indicate that he owes Graham Manufacturing Company for this purchase.

MERCHANDISE PURCHASES

Sept. 10	300 00		

GRAHAM MANUFACTURING COMPANY

		Sept. 10	300 00

When the account is settled, the Graham Manufacturing Company will debit cash and credit the account of Frank Smith. In this way their records show his account closed. Frank Smith, in turn, will credit cash when he pays the bill and charge the Graham Manufacturing Company, thus closing their account on his books.

In modern business, this form of credit has had many of its disadvantages removed. In former days, the book entry itself was about the only evidence the seller had of the customer's indebtedness. The buyer, also, had only the record of the seller to fall back upon, and many difficulties arose. These conditions still exist in some lines of business, but in most

instances there are other evidences of the debt besides merely the book entry. In the department store there is the sales slip giving minute details of the purchase, usually the identification coin number, as well as the checkings of the shipping and delivery departments. In the mail order house there are, first, a written order signed by the purchaser on which appear the checkings and symbols of the various departments in the process of packing and shipping the goods; second, the bill of lading signed by a representative of the transporting company; and third, the signature of the buyer on receipt of the goods from the carrier. In most manufacturing industries and wholesale houses, goods are not usually shipped until a signed order or contract is in hand. The chance for dispute over ordinary book accounts has, therefore, been greatly reduced by these methods. While in only a small percentage of these open book account credits is there a definite written promise to pay, the order, the acceptance of goods, book entries, shipping receipts, are all evidences of an implied promise to pay. When proper care is taken in completing records in modern merchandizing systems, there is usually little trouble in proving the debt when an account is questioned. The open book account is a quick, easy way of recording the credit transactions, and, as the element of confidence increases in any given trade area, the success with which this type of record can be used also increases.

Promises to Pay.—That form of credit record which is called a promise to pay is the one which is more closely connected with our original definitions of the subject of credit. As its name implies, it is a written record in which a promise is definitely made by one or more persons, firms, or organizations to pay in the future for value received in the present. The medium in which payment is to be made is generally money and the time for payment is either a specified date in the future

or on demand. Individuals often make these promises to banks, and banks and other financial institutions find themselves both the payors and payees in such transactions. The open book account is only a record in the hands of one party with an implication that the credit transaction will be completed. The element of confidence is greater in the case of the book account than in that of the promissory note, though the promissory note is a step further in the use of formal documents.

The book account to a certain extent is a receipt for goods and is almost inseparable from the trade aspect of the transfer. The promissory note is often separated entirely from the trading aspect and has within itself only the financial consideration, reciting "for value received," and generally failing to specify particular transactions. If question arises, the actual practice is that the transaction has to be traced back through the book records and connected with a particular note, though legally the promise acknowledging the debt stands alone.

Bonds and Stocks.—Promises to pay often involve investment credit as well as mercantile, bank, and personal credit. The bonds of corporations, often secured by mortgages, are promises to pay and are credit instruments. Bonds are generally long time obligations. They carry on their face a complete description of the security behind them, conditions under which the issuance has taken place, the relations of the company to trustees and bond houses, and any other data necessary to a full understanding of the obligation. These conditions vary in each case, it being very uncommon for two bonds to carry the same description. Bonds are often readily transferable by endorsement and delivery. In most states they are negotiable. They are often used as collateral in the securing of other loans.

Technically the stock of a corporation is not a credit instrument. It is a receipt for money invested in a business, a share of the assets of which belong to the individual who puts

his money into the enterprise. He does not expect interest on money loaned,—he wants profits on business transacted with his money. Some economists and credit men have inferred that there is a certain type of accountability arising out of this relationship which makes stock ownership a credit relation. It is true that ownership of stock by an individual in a corporation where the control is vested in the hands of a few others is not, from an economic point of view, very different from the ownership of a bond in the same organization so far as questions of management and risk are concerned. The type of the income expected, however, is essentially different in character from that received from a bond investment. The holder of stock is interested primarily in the profits of a concern. He can only hope to reap his reward for entrepreneurial sagacity through the success of the enterprise as a going concern. The bond holder, on the other hand, may get interest and principal from a concern which has failed as a productive unit in the business unit in the business world. The bond holder has loaned his money hoping to receive interest as a payment for the use of money with regard to which he himself has endeavored to eliminate all risk. He has taken no part in the management of the enterprise concerned and can have no interest in excess income.

Orders to Pay—Check.—The check is the most common form of the order to pay and is a written order drawn upon a bank by a depositor, a bank cashier, or another bank, requesting the bank to pay on sight a certain sum of money to the order of the person or organization named on the face of the check. The check has become today the great substitute for other forms of the medium of exchange. Hundreds of thousands of people now use checks for the payment of even small amounts and among the wholesale trade practically all settlements are made with checks. The check itself is a negotiable instrument, often

transferred from hand to hand by half a dozen individuals before it is finally passed out of use. This is particularly true in the case of communities where certain names are well known.

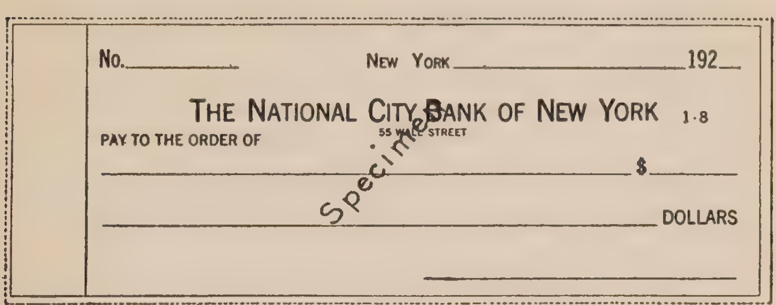


Figure 2. Check

The practice of endorsement, therefore, raises this credit instrument of limited acceptability to a position of general acceptability.

If the maker proves to have insufficient funds, the check becomes a direct promise of the endorser, or, if there is no en-

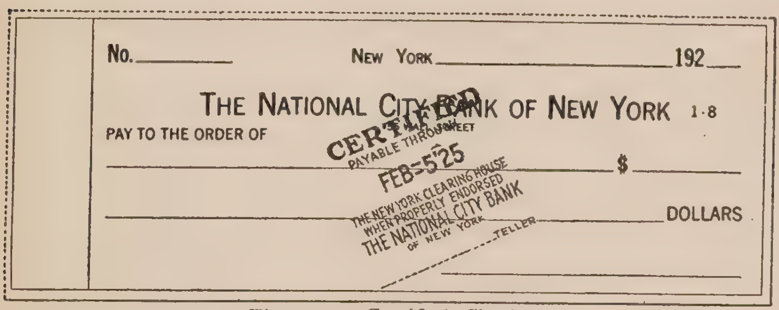


Figure 3. Certified Check

dorser, it becomes the promise of the maker and the holder can have direct recourse. In some cases it is necessary for the maker of the check to establish beyond the question of a doubt that he has funds in the bank upon which he has drawn his check. He does this by asking the bank's cashier or teller to

stamp the word "certified" across the face of the check and initial the certification. This, as the bank's promise to pay, adds to the security of the check. The use of certified checks is often desirable in the case of C. O. D. shipments where the buyer is unknown to the seller and little time is available for investigation of his credit standing. Sometimes the object is attained by the deposit of the check of the maker with the bank, in return for which he receives a cashier's check, which becomes the promise of the bank to pay. An illustration of a check is shown in Figure 2. A certified check is shown in Figure 3.

Orders to Pay—Drafts or Bills of Exchange.—Another form of the order to pay is the draft or bill of exchange involving three parties, none of which need be a bank though banks are often parties to the arrangement. Stanley F. Brewster in "Legal Aspects of Credit" has defined a draft as "an unconditional order in writing by one person to a second person directing the payment to another of a sum of money absolutely and at all events."

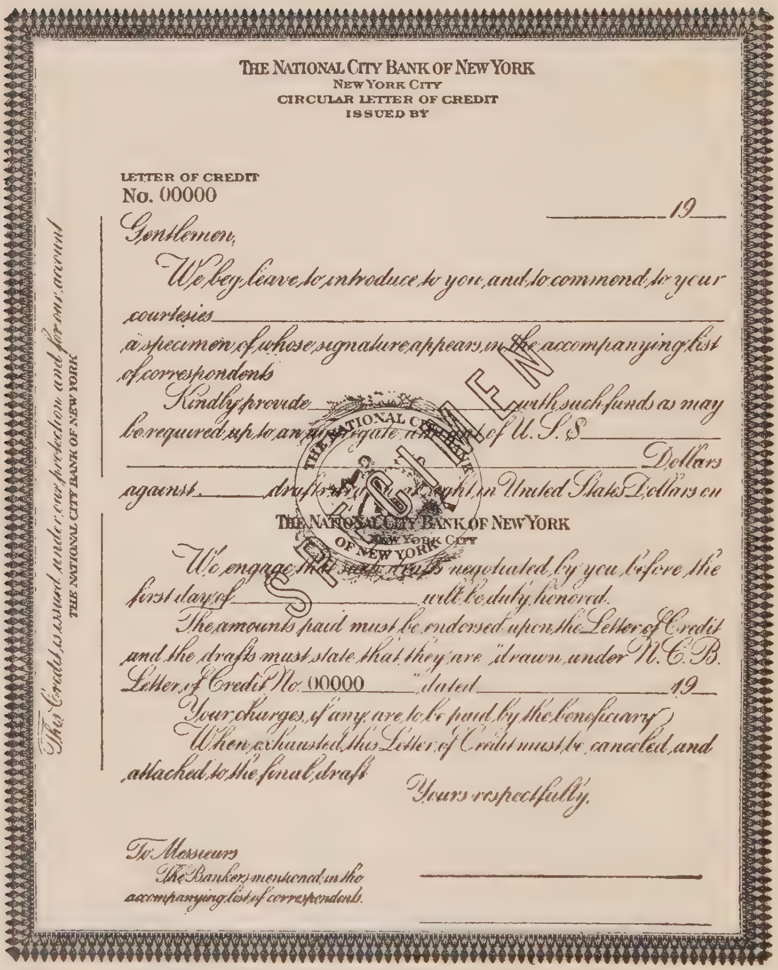
Drafts, or bills of exchange, have been classified in several ways. According to *place* they are *domestic* or *foreign*. The domestic order, generally called the draft, is used when the point upon which the order is drawn is outside of the United States. According to *time* they are "sight," "demand," or "time." The question of time is merely the date at which payment is to be made. Some are payable so many days "after sight," while others are payable a certain number of days after arrival of the goods. Presentation to the drawee sets the date for measuring time in a bill drawn "at sight" or a certain number of days "after sight." Such presentation also marks the point from which time is to be measured after the arrival of goods. According to *party* they are "trade" or "banker." This involves a distinction between persons, firms, or corporations, and trade organizations. If a bill is drawn on any organization

other than a bank, it is called a trade bill, even though the payee may be a bank. When the drawer is a bank, a bank check is used. According to *purpose* they are "commercial" or "finance." When it becomes necessary to transfer balances or borrow funds from other institutions, financial bills are used, while commercial bills are those which are secured by the goods involved and which arise out of actual commercial transactions.

To put a time draft or bill of exchange into final form the drawee (or person who owes the money) is asked to write his acceptance across the face of the instrument, thus acknowledging the order addressed to him and by his signature completing an agreement to pay it on maturity.

Orders to Pay—Letters of Credit.—Letters of credit are of two general kinds,—the letter of credit issued for the convenience of travelers, and letters of credit used in opening credits with banks against which shipments are made to foreign countries, or distant points within the same country. The letter of credit serves as evidence to those interested, either banks in general or a particular correspondent that a certain bank has committed itself to a certain line of credit. The letter of credit is the written instrument by means of which approval is given to this type of operation.

The traveler's form of letter of credit is the request of a bank or firm selling the credit to another bank to advance money, or release goods, to the person named. These letters of credit are then presented to the bank or firm addressed, where funds or goods may be obtained. The bank or firm on which credit is issued is repaid by the house issuing the credit. Such a letter of credit is usually issued in the form of a circular letter to its correspondents in specified places throughout the world authorizing sight drafts up to a certain amount payable to the beneficiary.



THE NATIONAL CITY BANK OF NEW YORK
NEW YORK CITY
CIRCULAR LETTER OF CREDIT
ISSUED BY

LETTER OF CREDIT
No. 00000

_____________ 19___

Gentlemen,

We beg leave to introduce to you, and to commend to your courtesies _______________ a specimen of whose signature appears in the accompanying list of correspondents.

Kindly provide _______________ with such funds as may be required up to an aggregate amount of U. S. $_______________ Dollars against _______ drafts drawn at sight in United States Dollars on

THE NATIONAL CITY BANK OF NEW YORK
NEW YORK CITY

We engage that such drafts negotiated by you before the first day of _______________ will be duly honored.

The amounts paid must be endorsed upon the Letter of Credit and the drafts must state that they are "drawn under N. C. B. Letter of Credit No. 00000 ______" dated _______________ 19___

Your charges, if any, are to be paid by the beneficiary.

When exhausted this Letter of Credit must be canceled and attached to the final draft.

Yours respectfully,

To Messieurs
The Bankers mentioned in the accompanying list of correspondents.

This Credit is issued under our protection and for our account
THE NATIONAL CITY BANK OF NEW YORK

SPECIMEN

Figure 4a. Traveler's Letter of Credit (face)

PAYMENTS MADE UNDER THIS LETTER OF CREDIT MUST BE INSCRIBED ON THIS PAGE AND MUST NOT EXCEED IN THE AGGREGATE........................DOLLARS, U. S. CURRENCY

DATE	PAID BY	AMOUNT IN WORDS	IN FIGURES
			$

WHEN EXHAUSTED THIS LETTER OF CREDIT MUST BE CANCELED AND ATTACHED TO FINAL DRAFT

Figure 4b. Traveler's Letter of Credit (back)

When the traveler desires to provide himself with local currency he applies to the proper bank and signs a sight draft on the issuing bank or its central correspondent abroad. Identification takes place through reproduction of the signature on the letter of identification on the sight draft. An appropriate page, ordinarily the back of the sheet, is used to record all payments made.

The commercial letter of credit is used in the same way, but instead of merely taking care of the personal needs of an individual it is used to facilitate the purchase and sale of merchandise. Merchants receiving the letter of credit can immediately ship their goods to any part of the world knowing that, if conditions are met, they can have drafts on their local bank honored at once on presentation of the credit letter with the proper accompanying documents. It is not to be inferred that these letters of credit are all the same. Their usefulness arises out of the fact that all of the variations in trade practices and differences in trade terms can be reflected in the instruments themselves.

Letters of credit are *revocable* or *irrevocable* depending on whether or not the bank which opens the credit reserves the right of withdrawal before a certain date.

Letters of credit are *confirmed* or *unconfirmed* depending on whether or not, by the terminology of the instrument, it is intended that the bank notifying the beneficiary makes the opening bank's obligation its own. If the notifying bank accepts this commitment, it is a confirmed letter of credit.

The Trade Acceptance System.—Another credit instrument, more commonly used before the Civil War and after the time of the establishment of the Federal Reserve System, than in the intervening period, is the Trade Acceptance. Originally, the plan developed from the custom of asking the buyer to look over the itemized bill and write his acceptance of the goods

FORM B

THE NATIONAL CITY BANK OF NEW YORK
55 WALL STREET

IRREVOCABLE CREDIT NO.

NEW YORK

ALL DRAFTS DRAWN MUST BE MARKED:
DRAWN AS PER ADVICE NO. B

DEAR SIRS:

WE HEREBY AUTHORIZE YOU TO VALUE ON
FOR ACCOUNT OF
UP TO THE AGGREGATE AMOUNT OF
AVAILABLE BY YOUR DRAFTS AT FOR INVOICE COST
TO BE ACCOMPANIED BY CONSULAR INVOICE BILLS OF LADING
DRAWN TO THE ORDER OF
AND COMMERCIAL INVOICE EVIDENCING SHIPMENT OF

ORIGINAL

INSURANCE

BILLS OF LADING MUST BE DATED NOT LATER THAN
BILLS OF EXCHANGE MUST BE NEGOTIATED NOT LATER THAN

A COPY OF THE CONSULAR INVOICE, COMMERCIAL INVOICE, AND ONE BILL OF LADING MUST BE FORWARDED BY FIRST MAIL DIRECT TO

ATTACHING TO THE DRAFT A STATEMENT TO THAT EFFECT. ALL REMAINING DOCUMENTS MUST ACCOMPANY THE DRAFT.

THE AMOUNT OF ANY DRAFT DRAWN UNDER THIS CREDIT IS TO BE ENDORSED ON THE REVERSE SIDE HEREOF.

WE HEREBY AGREE WITH THE DRAWERS, ENDORSERS AND BONA FIDE HOLDERS OF DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT THAT THE SAME SHALL BE DULY HONORED ON DUE PRESENTATION TO THE DRAWEE.

YOURS VERY TRULY,
THE NATIONAL CITY BANK OF NEW YORK

Figure 5. Commercial Letter of Credit

and terms, arranging for payment at a certain date and place. Later a separate document was used to record the obligation and make convenient the "banking" of the paper. Before the Civil War it was customary in the trade to use acceptances in the payment of trade obligations. The type of competition prevalent after that time led to the encouragement of the use of open book accounts. Since 1914 a strenuous effort has been made to revive the use of trade acceptances, although with only limited success. A trade acceptance arises when, in payment for a current merchandise sale, a draft is drawn to order with a definite maturity date, and the firm or person upon whom it is drawn acknowledges by signature and writing that it recognizes the debt and agrees to the terms on the face. Thus it becomes two-name paper. Indorsers also become responsible.

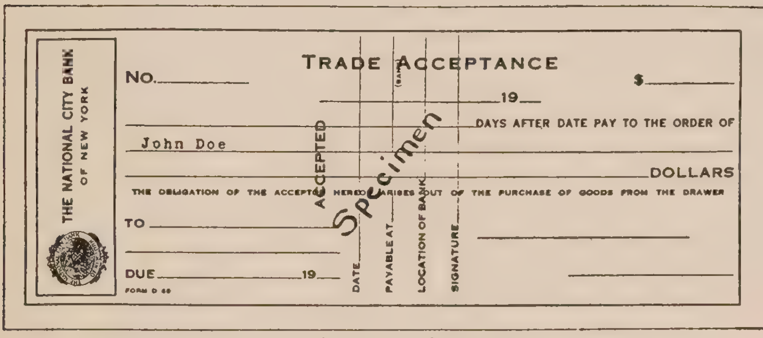
The use of the trade acceptance may be illustrated as follows: X, who is a manufacturer in Chicago, sells goods to Y. who is a wholesaler in New York. When X sends his invoice, he also sends to Y a sixty or ninety day draft drawn on Y. If Y wishes to pay X at once by means of cash, he tears up the draft; if he wishes to pay X later (if he is buying on "time") he accepts the draft by writing "accepted" across the face of the instrument, indicating the bank at which he wants to pay the draft when it comes due. He then signs it and returns it to X. X can either have it discounted at his bank, or hold it until it is due, and then present it at Y's bank for payment.

If X desires to discount the paper, he must be able to show that it has arisen out of an actual commercial transaction, either domestic or foreign. That is to say, the financing must have taken place through the movement of goods from original producer to ultimate consumer, and each situation which has given rise to the existence of commercial paper must have been such that the paper is self-liquidating in character. This phrase means that as the goods have been passed on down the

credit chain the paper in each transaction has been capable of liquidation through the respective transfers themselves.

An example of the Trade Acceptance is shown in Figure 6.

One distinctive and important feature of the Trade Acceptance is that it indicates the source from which each item arises, namely, that of a current transaction in the sale and purchase of goods. The Trade Acceptance is not intended to be given for old debts, for the purchase of fixed assets, or in any way to be the instrument of credit in a transaction which is not liquid in character. The regular course of business must


THE NATIONAL CITY BANK OF NEW YORK

No.

TRADE ACCEPTANCE

$

19

DAYS AFTER DATE PAY TO THE ORDER OF

John Doe

DOLLARS

THE OBLIGATION OF THE ACCEPTOR HEREOF ARISES OUT OF THE PURCHASE OF GOODS FROM THE DRAWER

TO

DUE 19

ACCEPTED

DATE

PAYABLE AT

LOCATION OF BANK

SIGNATURE

Specimen

Figure 6. Trade Acceptance

make the paper self-liquidating, the sale of the goods themselves providing the money for the retirement of the paper. It is not "sight draft and bill of lading attached." It does not imply "cash on delivery." It should not be used as a note. If it does not conform to specifications it cannot be discounted by a bank in the hope that rediscount with the Federal Reserve Bank can take place.

In the enthusiasm to revive the use of this system, many exaggerated claims were made for it, and its supporters intimated that many evils of credit misuse would be eliminated by the mere adoption of a new system. This has led to a great deal of opposition, which has hindered development. Never-

theless, it is undoubtedly true that this plan can be used advantageously in many more situations than is now the case.

In substituting for the open book account a written statement signed by the buyer that at a certain time a certain amount of money is to be paid, much is done to insure accuracy in collection policy. It is also argued that simplicity is gained, for all records are concentrated in one instrument, and letter of transmission, collection letter, reminders, statement, are combined. The credit manager can more easily estimate his collections, assuming that the majority of accounts are handled on a Trade Acceptance basis. The definite date of payment also makes it possible to be more careful in over-extensions of credit. The seller also finds in his hands orders to pay accepted by his customers. After receiving his regular line of credit on his own statement, he can present this two-name paper for discount to his bank, and, according to the indications of the Federal Reserve Board, he ought to be able to secure more funds for his business purposes. Under the open account system, the seller's funds are tied up until the accounts are paid.

On the other hand, there is a danger of using trade acceptances as a means of establishing credit where it is unjustified. Acceptance credit should be measured on the same basis as open book account credit. Sellers sometimes object because of the contingent liability involved, in that the name of the seller is liable if the acceptor fails to meet the obligation.

Many of the advantages of the trade acceptance could be secured on the open book account plan, if the proper education as to sound credit methods could be carried on. The trade acceptance seems to emphasize some fundamental considerations, and makes more likely an adherence to them.

Most banks have been in favor of the plan. Where discount takes place, more business is brought to the bank, and the trade acceptance itself forms an addition to the reserve readily

discountable at the Federal Reserve Bank. The bank finds in its possession double-name instead of single-name paper.

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CHAPTER VI

LEGAL ASPECTS OF CREDIT INSTRUMENTS

Negotiability.—Legal points arising out of the use of credit instruments concern chiefly negotiability and subsidiary documents of title. The negotiation of a credit instrument refers to its legal transfer from one person to another, together with all rights of the original holder. If the debtor manifests his intention of paying either the creditor or any one else to whom the creditor may transfer it, the instrument is negotiable; if the instrument is payable to the order of the creditor alone it is non-negotiable. Some instruments of credit are strictly negotiable, some have the attribute of negotiability in a limited degree, and some are non-negotiable.

Article II, Paragraph 20, of the Negotiable Instruments Law defines negotiability as follows:

> An instrument to be negotiable must conform to the following requirements:
>
> 1. It must be in writing and signed by the maker or drawer;
> 2. Must contain an unconditional promise or order to pay a sum certain in money;
> 3. Must be payable on demand, or at a fixed or determinable future time;
> 4. Must be payable to order or to bearer; and
> 5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

The intention of the maker to create negotiable paper is thus clearly indicated, the promise to pay is absolute and the manner of payment is certain.

Under these negotiable instruments, we have checks, drafts, promissory notes, acceptances, judgment notes and post-office and express money orders.

The five essentials above named must be present, it is true, in an instrument of this kind but in actual business transactions, these standards are frequently not met. There are, therefore, certain recognized rules which are applicable. These are set forth in Article II, Paragraph 36, of the Negotiable Instruments Law, which reads as follows:

> Where the language of the instrument is ambiguous, or there are omissions therein, the following rules of construction apply:
>
> 1. Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, reference may be had to the figures to fix the amount;
>
> 2. Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof;
>
> 3. Where the instrument is not dated, it will be considered to be dated as of the time it was issued;
>
> 4. Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail;
>
> 5. Where the instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it as either at his election;
>
> 6. Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign he is to be deemed an indorser;
>
> 7. Where an instrument containing the words "I promise to pay" is signed by two or more persons, they are deemed to be jointly and severally liable thereon.

There may be certain defects in negotiable instruments which are non-essential, and do not affect the validity or negotiable character of the instrument. Article II, Paragraph 25, of the Negotiable Instruments Law, reads as follows:

> The validity and negotiable character of an instrument are not affected by the fact that:
>
> 1. It is not dated; or

2. Does not specify the value given, or that any value has been given therefor; or

3. Does not specify the place where it is drawn or the place where it is payable; or

4. Bears a seal; or

5. Designates a particular kind of current money in which payment is to be made.

But nothing in this section shall alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument.

The Negotiable Instruments Law, from which the foregoing quotations have been made, has been adopted by every state, as well as Alaska, District of Columbia, Hawaii, and the Philippine Islands. The statute as enacted in different states varies in some minor details but the principal provisions are, with few exceptions, practically identical in all of the states.

Notwithstanding the rules enumerated in practice it is well, where irregularities exist, to notify the maker, and have him request the drawee to honor the instrument regardless of the defect. This may often avoid delay in payment, or possible loss of the amount involved where failure of the maker in the meantime occurs.

One requisite to a negotiable instrument upon which emphasis should be put is the "consideration" necessary. "Any consideration sufficient to support a simple contract" may be the consideration for a negotiable instrument. A simple promise for which there has been no consideration is unenforceable in law. A consideration is an act or forbearance, or the promise of it, done or given by one party in return for the act or promise of another.

Although a consideration is necessary for a negotiable instrument, the plaintiff in an action on a bill or note does not need to prove that he gave one. Absence of consideration is a "matter of defense" which the defendant must prove in order

to defeat the action. "Every negotiable instrument is deemed prima facie to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value," as stated in Section 24 of the Negotiable Instruments Law.

Limited Negotiability.—The distinguishing feature between the class of instruments just considered and those of limited or restricted negotiability lies in the fact that the former are subject to recovery by a holder in due course at face value without set-off, while the latter might be better classed as merely transferable instruments, and subject to set-off under certain conditions.

In this class are included bonds, mortgages, letters of credit, and those instruments more properly known as documents of title such as bills of lading and warehouse receipts. In spite of the fact that stocks are not technically credit instruments but rather evidences of ownership, the relationship to the credit risk is so close that the discussion would be incomplete without reference to some of the legal points involved in this instrument of limited negotiability. As certificates of stock are issued in many different forms, it is always important to carefully read the conditions whenever transactions involve the handling of certificates of stock. When stock has been subscribed but not paid in, creditors in case of insolvency, can compel payment. Beyond this liability, stockholders in most states have no liability to creditors of the corporation.

Bonds are transferable by endorsement and delivery, and in most states are negotiable. The same rule holds in the case of mortgages, except that negotiability is not so common. The laws as to mortgages on real estate and mortgages on other property, known as chattel mortgages are so at variance in the different states that nothing short of a consultation of the law should suffice where such an instrument appears in

determining the credit to be given to a customer. It is important to remember that as a general rule mortgages must be filed or recorded with the properly prescribed officer, usually the county recorder, town or city clerk.

Dishonor and Protest.—The dishonoring and protesting of bills of exchange is a point of considerable importance in handling negotiable instruments. An instrument is "dishonored by non-payment when it is duly presented for payment and payment is refused or cannot be obtained." The holder of the instrument is the proper person to give notice of dishonor, and this should be given to the last endorser. He may in turn give notice to prior endorsers or to the maker.

Article VIII, Paragraph 174, of the Negotiable Instruments Law, requires that notice of dishonor be given as follows:

> Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times:
>
> 1. If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following;
>
> 2. If given at his residence, it must be given before the usual hours of rest on the day following;
>
> 3. If sent by mail, it must be deposited in the postoffice in time to reach him in usual course on the day following.

Article VIII, Paragraph 175, of the Negotiable Instruments Law, reads as follows:

> Where the person giving and the person to receive notice reside in different places, the notice must be given within the following times:
>
> 1. If sent by mail, it must be deposited in the postoffice in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on that day, by the next mail thereafter.
>
> 2. If given otherwise than through the post-office, then within

> the time that notice would have been received in due course of mail, if it had been deposited in the post-office within the time specified in the last subdivision.

Where a draft or bill of exchange is protested, the first step is its formal presentment, for acceptance or payment, as the case may be; the second is "noting" the dishonor; and the third, the preparation and execution of the certificate of protest. Each of these actions must be taken by a notary.

Article XIII, Paragraph 261, of the Negotiable Instruments Law, reads as follows:

> The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify:
>
> 1. The time and place of presentment;
> 2. The fact that presentment was made and the manner thereof;
> 3. The cause or reason for protesting the bill;
> 4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found.

Documents of Title.—These include bills of lading and warehouse receipts and are not negotiable instruments in the same sense as a sight draft for they provide for the transfer of title to goods rather than the transfer of money. The Uniform Bills of Lading Act has been adopted by twenty-three of our states and territories. This act permits a carrier to evade responsibility for a misdescription of the goods if the words "Shipper's weight, load and count" are inserted in the bill of lading. When the goods are loaded by the carrier the Federal Act covering this subject admits no evasion of this responsibility. The enactment of the Uniform Act has served to greatly increase the negotiability of bills of lading as it has greatly facilitated the ready transfer of the instrument by giving a good title to the holder who has taken it in good faith, and without notice of any defect, regardless of how he

came in possession of it. This, under the former rule still prevailing in some of the states, was and is not the case. Under the latter rule, a person wrongfully in possession of a bill of lading cannot validly negotiate it. All duplicate bills of lading must be plainly marked "duplicate." There are really two distinct forms of bills of lading,—the straight bill and the order bill. The Federal Bill of Lading Act makes the difference clear, briefly as follows:

> 1. *Straight Bill:* A bill in which it is stated that the goods are consigned or destined to a specified person. Straight bills shall be marked "not negotiable."
>
> 2. *Order Bill:* A bill in which it is stated that the goods are consigned or destined to the order of any person named in such bill. (Order bills are also termed "Negotiable Bills," and the names are used interchangeably.)

Transfer and negotiation take place under the following regulations:

> 1. *Negotiation:* (a) By Delivery: An order bill may be negotiated by delivery where, by the terms of the bill the carrier undertakes to deliver the goods to the order of a specified person and such person or a subsequent indorser has indorsed it in blank.
>
> (b) By Indorsement: An order bill may be negotiated by indorsement either in blank or to a specified person.
>
> 2. *Transfer:* A bill may be transferred by the holder by delivery, accompanied by an agreement, express or implied, to transfer the title to the bill of the goods represented thereby.

Warehouse receipts, like bills of lading, are of a twofold character, in that they are a receipt for goods stored in a warehouse, and also a contract to re-deliver when demanded. Some states have statutes providing that no warehouseman shall issue a warehouse receipt until goods are actually received in storage, to avoid injury to innocent third persons. Warehouse receipts are not actually negotiable instruments in the ordinary use, being treated, as indicated, by the heading under which this form has been described, but in some states they

have by statute been declared to be negotiable and transferable by endorsement and delivery, the same as other negotiable instruments, with like remedies.

Non-negotiable Instruments.—This group of credit instruments may, at first glance, appear to be entirely foreign to such a work as this. They are, in fact, just as important as either of the previous groups, and the improper use or the careless preparation and completion of them frequently leads to losses that might otherwise be prevented. If for any reason payment cannot be procured, an entire business transaction is lost to the creditor. The creditor may demand payment, and employ legal processes; but it is necessary that he have the written evidence of value given. Under this class of non-negotiable instruments are orders, shipping and delivery receipts, invoices, book accounts, contracts of sale, conditional sales contracts, and leases.

A written order is a very essential thing in modern business, and frequently is the only contract between the buyer and seller. A salesman, in the absence of extraordinary circumstances, may not bind his principal by the acceptance of an order for the product. His function is merely to solicit orders and submit them to his principal, who may accept or reject them. The following is quoted from an order form in use:

> ORIGINAL ORDER—THIS MUST BE SENT TO THE OFFICE
>
> This order is taken with the understanding that it is positive and not subject to change or cancellation unless so specified hereon, and any agreement not stated on this order will not be recognized. All orders taken by salesmen are binding on the Company only when accepted by its office or branch office from which shipment is made.

An order, until it has been acknowledged in writing, shipment of goods, or otherwise, is subject to cancellation. Where

acknowledgments are made in writing, by shipment of goods, or otherwise, and the terms of the order involve extension of credit, and credit has not been approved, great care should be exercised, as carelessness on this point may at any time involve a seller in a suit for damages, if subsequently it is determined not to ship on credit. In such a case it would be incumbent for the seller, after having agreed to extend the customer credit, to prove he was unworthy of credit. That in many cases would be a hard thing to do, even though all the necessary evidence to convince the credit man that the buyer is unworthy of credit was at hand. It is a particularly difficult situation because the information gathered to determine a buyer's credit is for the most part confidential, and in many cases, as indicated in a preceding chapter, the seller is actually under contract with the sources of the information not to divulge it under penalty of being liable for a loss by damages incurred by such use of the information furnished.

After the order has been received, prices, quantities, grades, terms, etc., checked and found satisfactory, an acknowledgment is mailed to the customer accepting the order and agreeing to ship goods. In the order and acceptance there is a *contract to sell*, but the actual *sale* does not take place until delivery is made. So the questions naturally arise, What is the difference between a *contract to sell*, and a *sale*, and what constitutes delivery, or passing of title? The answers are quoted from the Uniform Sales Act, which has been adopted by twenty-six of our states and territories to date. A sale and contract to sell are defined as follows:

> A sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration, called the price.
>
> A contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration, called the price.

As to delivery and passing of title, we quote the following:

1. Unconditional contract to sell specific goods in a deliverable state: Property passes when contract is made, even though delivery or payment or both be postponed.

2. Contract to sell specific goods where something remains to be done to put them in a deliverable state: Property passes when that thing is done.

3. Contract where delivery is made "on sale or return" or other similar terms: Property passes on delivery to buyer, but he may revest it in the seller by returning or tendering the goods within the time fixed in the contract, or, if no time has been fixed, within a reasonable time.

4. Contract where delivery is on approval or other similar terms: Property passes:

(1) When the buyer signifies his acceptance or does any other act adopting the transaction;

(2) If the buyer retain the goods without signifying acceptance or giving notice of rejection and a time has been fixed for their return, at expiration of such time; if no time has been fixed, at the expiration of a reasonable time. (What is a reasonable time depends on the circumstances of the case.)

5. Contract to sell by description unascertained goods or "future" goods: Property passes to the buyer when such goods in a deliverable state are unconditionally appropriated to the contract, either by the seller, with the buyer's consent, or by the buyer, with the seller's consent. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

(Except in the cases specified in Rule 6 and in paragraph XIV, an unconditional appropriation of goods to a contract to sell is presumed to have taken place upon delivery to the buyer, a carrier or a bailee (whether named by the buyer or not), for transmission or holding for the buyer, even though the price must be paid before the buyer can receive delivery and goods are marked with the words "C.O.D." or their equivalent.)

6. Contract requiring seller to deliver the goods to the buyer, or to prepay transportation charges to a place designated by the buyer: Property does not pass until the goods have been delivered to the buyer or have reached the place designated.

Where a different intention as to delivery appears by agreement, any act which the parties intend to represent such delivery, constitutes sufficient delivery.

The next thing to be considered is proof of delivery. Under certain conditions, for instance where goods are in the hands of a third person, or of the seller, notice that goods are being held subject to buyer's order constitutes delivery. Under such conditions proof of notice having been given is sufficient. Then, in addition to bills of lading covering shipments by rail and boat, we have other evidences or proofs of delivery of goods so far as the physical merchandise is concerned. These are the various forms of receipts used by trucking, drayage, and express companies, as well as receipts taken from customers by business houses making their own deliveries. No particular form of receipt is necessary so long as it shows date and place of delivery, an adequate description of the goods, from whom received, and properly signed by the receiver of the goods. All such receipts and proofs of delivery should be properly preserved in case there should be a later dispute regarding delivery.

The next step in the process is the billing or invoicing for the goods, or service. The bill or invoice should therefore show, in addition to weight, measure, description of articles, prices, dates, method of delivery, etc., the terms and conditions under which sale is made, and when this is not practical, then records should be made on the bill or invoice of the terms under which sale was made.

References

Brewster, Stanley F. Legal Aspects of Credit, pp. 403–439.

Dewey, Davis R. and Shugrue, Martin J. Banking and Credit, Chap. VI.

Part II.—Sources of Information and Its Analysis

CHAPTER VII

THE PERSONAL INTERVIEW

Human Nature at First Hand.—Commerce today has assumed such vast proportions that it is difficult for creditors and debtors to develop personal relationships in business which give opportunity for and stimulate the personal interview. Though it has been possible to create letters which breathe the personality of the house, which express interest in the customer, which seek tactfully to secure his confidence, which appeal to a sense of fairness and emphasize house good-will, yet when a new credit of doubtful value is sought, when a debtor becomes heavily involved, and when any unforeseen business complications arise, it is the personal interview that determines future conduct of the crediting house. Many lines of business report that a personal interview is only possible with 2, 10, or 20% of their customers, yet it is fair to assume that this small percentage of interviews has a great deal to do in keeping the losses of the house nearer the possible minimum, and increasing sales and good-will.

Opening the Account.—Possibly of greatest benefit to the crediting house are those interviews which are secured either at the time of initial credit granting, or when some business contingency has arisen to embarrass the debtor in a financial way. The interview at the time of initial credit

granting proves a great aid to the credit manager. From financial reports and agencies he is able to secure an adequate idea of capacity and capital, but his estimate of character must be drawn from records of past business conduct. He is, therefore, better able to estimate this third and vitally important factor in credit granting if he meets and talks with the credit seeker; his correspondence in the future takes on a more personal element; he knows, to a certain extent, the characteristics and idiosyncracies of the person with whom he is dealing and uses this knowledge in a way that will further the best interests of his house.

The Financially Embarrassed Debtor.—In all large organizations a personal interview is sought with the debtor who is financially pressed. This may mean a visit from the debtor to the crediting house or the sending of a personal representative from the credit department to the business of the debtor to "look over the ground." This representative must secure a direct knowledge of the situation and suggest remedial measures. The situation may be such as to warrant a visit from the credit manager himself, or the salesmen of the house may have that touch of business judgment which would render their reports reliable and their visits of value to the credit department. It is believed that credit extension demands a study of human nature. There is, surely, no more thorough first-hand method than that of the personal interview.

Attitude of the Interviewer.—The personal interview is not a modern adaptation of ancient inquisitions, nor a financial third degree; it is a business call, friendly and helpful in spirit, during which the credit manager is enabled to secure, not only those basic facts which he afterwards checks with business agencies, but also that "indefinable something" which

gives evidence of character and perspicacity and stamps that customer as a possible good or bad credit risk. Financial statements are uncertain things, at best, but the good student of human nature (which the credit man should be) is able to place between the rows of figures an estimate of the character, business acumen and possible future success of the man with whom he is talking.

To secure, during this interview, those facts and impressions which are to be of most value in future credit transactions, it is necessary that the debtor be made to feel not only that the crediting house is friendly in its attitude but that the friendliness shown has a basic sincerity; that the house is genuinely interested in his problems and that this interest is not entirely based on the dollar and cents profit that may result from his transactions with them.

The initial impression of sincerity is gained at the personal interview, to be substantiated later by the dealings of the house with the customer. It is of great importance, then, that during the personal interview the credit man shall prove himself to be an excellent salesman, not only of himself and his own interest, but of the interests of his house. Friendliness may open avenues to confidences otherwise not obtained. The interview should be business-like, but it is neither necessary nor wise to resort to a cross-questioning that causes the debtor to feel that his word and his ability are doubted. He probably would not care to have any further dealings with a house that treated him that way.

Information to be Sought.—The information which it is desirable to gather during the personal interview varies with the case at hand. It is sometimes not the part of wisdom to ask questions that can be answered by supplementary information gathered from other sources. The line of business and the freedom with which the applicant gives information will

govern the scope and type of information received during the interview.

There are, however, several points which should be brought out in the interview. Some of these are of basic importance; others merely serve to throw additional light upon future credit possibilities of the applicant.

By tactful questioning concerning market conditions and the trend of his line, it will soon be apparent whether the applicant is shrewd or uninformed. Shrewdness does not insure honesty, but a clever buyer, by wise selection of goods, insures that they will be salable and thus increases his power to pay his bills at maturity.

Facts pertaining to the capital strength, organization, present conditions and the outlook of the applicant's business are often secured, unsolicited, during the personal interview.

If questions have arisen concerning the applicant's credit possibilities, either in the financial statement, through references, or from statements of salesmen, the personal interview affords an excellent opportunity for clearing up such situations. Such information can readily be checked elsewhere, and the frankness with which the prospective customer talks over these difficulties serves as an excellent measure of the character risk involved in extending him credit.

The following questions are suggested as the type of definite information which should be secured, directly or indirectly, during the personal interview.

1. In what kind of business are you engaged? Where located?
2. How long have you been at the present location?
3. In what kind of business were you formerly engaged? Where?
4. How long have you been in this particular line of business?
5. Who are some of your older creditors?

6. Do you own your business property? If not, what rent do you pay?
7. How much have you invested in your business?
8. If you have borrowed money to cover running expenses, how much?
9. What is the average amount of stock you keep on hand?
10. How much insurance do you carry?
11. What are your overhead expenses?
12. Have you any income outside your business?
13. From what source is money coming to pay for goods?
14. On what terms do you sell?
15. Where have you been buying heretofore?
16. What are your monthly sales?
17. What is the estimated amount of credit desired?

Advantages of the Personal Interview.—The personal interview usually proves an advantage to debtor and creditor alike. The man seeking credit should appreciate the personal interchange of confidence with the house with which he wishes to deal, because in that confidence he has an opportunity to show all his points of strength, to indicate that he possesses character, ability, and capacity, and to impress the credit manager with his own confidence in his enterprise. The credit man, on the other hand, can see the type of man in whose business venture he is joining as a sort of partner and by establishing a proper basis for the exchange of information, one with the other, can put himself in a position to aid materially in the success of the venture. Thus he develops a satisfactory account for his firm and helps to strengthen the business fabric of the community in general.

The credit man needs to know what the customer's weaknesses are, and if possible to get close enough to him to avoid the dangers which these weaknesses bring, and to help him become a better and larger customer by developing the stronger characteristics which are manifest. This is constructive credit

work. There is an increasing number of men who are recognizing and acting upon this new principle.

The initial granting of credit is not the only occasion for the personal interview. When the debtor becomes delinquent in payments, when his business is jeopardized through poor management, or unforeseen misfortune, the personal interview plays one of its most important roles. Here it behooves the credit manager to leave his desk, at times, and survey the difficulty at the field of action, to talk the situation over frankly with the debtor and perhaps with other of his creditors, and to then come to some decision as to settlement. It is true that financial dealings play a great part in the final decision, but if the character of the debtor has proved such as to warrant confidence, he is usually allowed to work out his own salvation with the guidance and confidences of his crediting houses. J. Pierpont Morgan had said that character is before money or property or anything else; money cannot buy it. Surely, if character plays such a vast role in modern commerce, the personal interview and further personal contacts are the first-hand methods for measuring it.

Many credit managers find it desirable to visit most of their customers at regular intervals. This is not primarily a visit for credit purposes though much valuable information is gathered. Supplementary data on all of the points indicated upon which information was to be sought in the first interview is gathered. The same questions are important. New developments are noted and a better understanding of the credit risk is secured.

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CHAPTER VIII

MERCANTILE AGENCIES, GENERAL AND SPECIAL

Nature of Demand.—Credit information serves as the basis upon which credit transactions take place. Any machinery by means of which this information can be secured more easily and its proper dissemination facilitated is a desirable addition to the economic structure. If large numbers of firms and business organizations find the information useful, it is more profitable to develop a central source where all can go and get the information they desire. This necessity for the accumulation of facts concerning credit risks has led to the development of the agency system in the United States. The mercantile agencies are of two distinct classes, the general agencies and the special agencies. The general agencies are vastly larger in scope than are the special agencies, gathering, as they do, information regarding all types of mercantile businesses. Their goal is the inclusion of every business firm, small or large, in their ratings. On the contrary, the special agencies limit themselves to particular trades or particular locations, believing that they can render better service by limiting the field of their activities.

Purposes.—The two most notable general agencies today are the Bradstreet Company and R. G. Dun and Company. These organizations have grown steadily and their service has grown broader and more comprehensive, always attempting to meet the needs of a rapidly growing economic community, which is more complex than it has been in the past and which

constantly demands more and more of all those organizations which seek to work as a part of it.

In the general operation of these agencies a system is provided for acquiring a knowledge of the mercantile condition of traders and for conveying that knowledge to others who seek it. Business organizations of the United States realize that each man and each firm develops a reputation, and it is this reputation which the mercantile agency endeavors to estimate fairly and to place the information upon which such estimates are made at the disposal of its patrons. Three essential features are implied in the compilation and dissemination of such information: careful investigation, frank cooperation and business honor.

The agency assumes the position of a confidential agent of each subscriber, keeping its transactions in confidence, never revealing the source of an inquiry. It does not and can not decide the credit limit of particular customers, but it serves to furnish information upon which the credit manager himself can make the decision.

The fundamental theory of trade investigation upon which the mercantile agencies base their work, may best be emphasized by two statements, one issued by an authority of the Bradstreet Company, one from the R. G. Dun and Company agency:

> A well managed credit amounts to ten fold the funds of a merchant: And he gains as much by his credit as if he had ten times as much money. Credit, therefore, is the greatest wealth to every one who carries on commerce. The mercantile agency has as its object the obtaining and communication of information relating to the amount of credit which one party to a credit transaction may prudently give and the other party may prudently accept.

> That if a man buys or sells goods, his ability to carry out his contracts is a proper subject for inquiry, and that the trader who does not or neglects to respond to a request for such a statement,

> fails in duty, and that public sentiment will relegate to the background that class of men who, for cause, are afraid to make a statement as it might develop a knowledge of existing financial weakness.

The commercial agency has come to have a world-wide influence upon commercial transactions. There are few organizations of any magnitude that do not recognize its necessity in the conduct of their business, and self-respecting individuals, firms, or corporations are never wholly indifferent to their standing as reflected in the reports of such an agency. That such an institution is a most potential factor is undeniable, and cannot for a moment be questioned by practical, progressive business men. The general agencies have made it possible for credit to exist in its highest, broadest sense, available to all deserving, with equal opportunity to grant and receive. The humblest and most remote dealer feels its beneficent working as surely and unerringly as does the dealer who is in closest touch with the centers of trade and commerce.

The conception and operation of this detailed, and in so far as is possible, exhaustive system of collecting credit information is peculiarly American, and it has been inhibited from transplantation to other countries by peculiar codes of laws, by the practically prohibitive interdict placed in most foreign countries on public records, the greater reserve regarding inquiry which prevails and the general attitude of the numerous governments. The last three decades, however, have seen a change and now the scope of the general agency has broadened until it includes not only information concerning American operations in the United States and Canada, but also American industry and enterprises carried on in foreign countries. For this purpose several branch agencies have been established in the American centers of foreign enterprise.

Systematic efforts were made by some of the larger concerns to learn something of the financial responsibility of their

customers. Men were sent out on the road to visit customers periodically, learn how they were getting along, collect moneys due, and endeavor to line up new customers for their houses. This was a rather expensive method, and consequently one of these traveling men, a Mr. Church, seeing an opportunity to fill a real need, opened up a bureau of credit information in New York shortly after the panic of 1837. About 1840 the first mercantile reference book was issued. The first mercantile agency was established by Lewis Tappan in New York in 1841; a second in 1842 under the name of Woodward Dusenbury; and in 1849 The Bradstreet Company was founded by John M. Bradstreet, a Cincinnati attorney. In 1859 R. G. Dun & Company was formed. Many other concerns have entered this line of endeavor, but The Bradstreet Company and R. G. Dun & Company, usually called "Bradstreet" and "Dun" for short, are today the two recognized leading general commercial agencies. No one starting in business today, whether operating on a cash or credit basis, can escape their investigations.

Organization and Plan of Operation.—The mercantile agency has an elaborate system covering the entire country with trunk lines running from the executive offices to the report offices in the various cities and with branch lines from all the principal cities to every town, village and hamlet.

The executive offices are located in New York City. In the case of the Bradstreet Company it is entirely separate from the reporting office at that point. These offices send out detailed instructions to the reporting offices which furnish a detailed report of the progress made. To each reporting office is allotted a carefully selected territory, accessible to it geographically and of which it is the logical trade center.

The classification for investigation is made upon two bases:

first, according to type of business—wholesaling, retailing, or exporting—and second, according to territory. The degree to which a territory is covered is determined by its trade importance, with reporting centers established at the important trade markets. These branch offices have an assigned territory to cover, accomplishing this through the means of the regular and special reporters. The regular reporters carry out the general routine of information collection, while the special reporters, often accountants and always specially trained, are used for the purpose of settling questions of mis-information and conflicting statements.

Responsibilities of Branch Offices.—Each branch office is responsible for the listing, rating, and information concerning all of the business firms in its field. It maintains an extensive organization for the purpose, including agents in the various county clerks' offices whose duty is to furnish daily a list of recorded evidence including deeds, mortgages, chattel mortgages, judgments, mechanics liens, bankruptcies, certificates of incorporation, certificates of assumed business liabilities, etc. On request such special information as may be desired regarding other matters of record is furnished. Every branch office is expected to subscribe to practically every newspaper in the field. Each newspaper must be read carefully regarding finance, deaths, changes in partnerships, new concerns about to engage in business or old ones about to discontinue.

Not only is all the information which is brought in carefully studied, but selected and thoroughly trained representatives are sent into every town and village to gather every item of information which could possibly affect the financial condition of any particular merchant or business house. The branch offices keep on file only reports of merchants in their particular district. If a distant office desires a report it asks the local

office to investigate and forward the information. Revisions are forwarded to the office originally requesting the information. The only case where duplicate copies exist is in the New York office. Where there has been a strong tendency toward concentration of certain types of industries in one locality, a different situation exists. For instance, Boston receives reports on all merchants engaged in the shoe business, Grand Rapids on all merchants engaged in the lumber and furniture businesses, and Providence on all merchants in the jewelry business.

Traveling Representatives.—Not all the small towns have their own personal representatives as the expense would be too great for the amount of service rendered available by such an arrangement instead, traveling representatives visit each town at regular intervals, check over and bring up to date the information on file regarding the business already listed, erase the names of those who have discontinued or add the names of any new concerns with their proper ratings. Each reporter remains in a particular section until the work has been completed. He may call on dealers, passing from store to store getting statements and references, later consulting all the leading authorities in the town regarding the different individuals under investigation. When these reporters are trained men, accustomed to interviewing, very complete and satisfactory reports result, containing specific data often unavailable by correspondence.

Various organization plans are used in cities. In some cases the city is divided into sections, and a reporter in each section is responsible for the listing, rating, and revising of all the business names in that particular section. In some of the larger cities reporters are made responsible for certain trades.

Information Secured.—Complete information is the goal of the agency, for the agency is a collector, not a creator, of facts. The information that the agency attempts to secure is varied; signed statements of assets and liabilities, together with references, particularly names, agents, meritable conditions and as much contributing information as can be tactfully extracted. This information, having been secured from the subject, is then verified, not as a question of veracity but as a matter of business prudence. The county records indicate whether or not the subject owns real estate and in whose name the title appears. The same records indicate judgments, mortgages, etc. Assessment rolls and authorities on real estate valuations verify asset items in the balance sheet. Banks and attorneys furnish much valuable information, though in some cases the reporter finds it better to use the bank to confirm rather than to advance information concerning residents of the particular locality.

As a factor in credit rating, the securing of the signed financial statement is becoming of increasing importance. Every business man, whether buying or selling merchandise or labor, should recognize it as his duty to furnish the other parties concerned in a transaction with satisfactory evidence that he has the ability as well as the disposition to carry out his agreement. A merchant's most valuable possession, aside from his assets, is a good reputation as a credit risk, and, under present methods of conducting business, the best way for him to prove his basis for credit is to submit a statement of his financial condition. Asking him to do so casts no reflection upon his character, honesty, or business ability, but is simply an effort to obtain information for intelligent action.

A merchant submitting a signed statement creates a favorable impression by his frankness, indicating that he has nothing to conceal and that he has a proper appreciation of obliga-

tion to those of whom he asks credit. Some merchants feel that by refusing to give a statement they are keeping their affairs secret. Such refusal does not stop investigation, though it may serve to handicap the reporter somewhat and cause some delay in getting the information to the mercantile house making the inquiry—and consequent delay in obtaining the line of credit. Every business man should know more about his affairs than can be ascertained from outside sources, and inasmuch as he will be listed anyway, it seems poor business judgment not to place the agencies in possession of complete information regarding his affairs in order that in the written report he may receive full justice.

Assignment of Ratings.—On the basis of the information gathered together a complete report is assembled and ratings are assigned by men who have had years of experience and who have a knowledge of this field of business. With respect to a business house located in a city this is done by the reporter conducting the investigation, subject to revision by his superiors. With respect to one located in the country, it is generally done in the office of the district by those responsible for such work.

Ratings are divided into two parts: (1) capital rating and (2) credit rating. If no unusual obstacles interfere in the investigation, the fixing of the capital rating is usually not difficult. The book worth of a business, however, and its worth for credit purposes are not often the same. Assets must often stand shrinkage, whereas liabilities show a tendency to increase. The reporter is obliged to consider not only the amount but the character of the principal assets and liabilities. The capital rating is the judgment of the rater as to the amount of commercial value or the par value of the assets which the firm rated may be considered to have in its business, all things

relating to the firm and the business being taken into consideration. It purports to estimate what this business is worth in cash. The credit rating does not merely indicate a certain fixed percentage of the capital invested for which the average business man may be considered good credit; it is a judgment rating in which are involved an estimate of character, business history, and social standing; it is the rater's opinion of the man's integrity and resources expressed in terms of money. Ratings of the Bradstreet Agency follow:

	Estimated Wealth	Grades of Credit		
G	$1,000,000 and above	Aa	A	B
H	500,000 to $1,000,000			
J	400,000 to 500,000	A	B	C
K	300,000 to 400,000			
L	250,000 to 300,000			
M	200,000 to 250,000			
N	150,000 to 200,000			
O	100,000 to 150,000	B	C	D
P	75,000 to 100,000			
Q	50,000 to 75,000			
R	35,000 to 50,000			
S	20,000 to 35,000	C	D	E
T	10,000 to 20,000			
U	5,000 to 10,000			
V	3,000 to 5,000	D	E	F
W	2,000 to 3,000			
X	1,000 to 2,000			
Y	500 to 1,000	E	F	
Z	0 to 500			

The Dun report is in different form. Their ratings are given on page following.

Estimated Pecuniary Strength				High	General Credit Good	Fair	Limited
AA.....	Over	$1,000,000......		A1	1	1½	2
A+....	$750,000 to	1,000,000......		A1	1	1½	2
A......	500,000 to	750,000......		A1	1	1½	2
B+....	300,000 to	500,000......		1	1½	2	2½
B......	200,000 to	300,000......		1	1½	2	2½
C+....	125,000 to	200,000......		1	1½	2	2½
C......	75,000 to	125,000......		1½	2	2½	3
D+....	50,000 to	75,000......		1½	2	2½	3
D......	35,000 to	50,000......		1½	2	2½	3
E......	20,000 to	35,000......		2	2½	3	3½
F......	10,000 to	20,000......		2½	3	3½	4
G......	5,000 to	10,000......		...	3	3½	4
H......	3,000 to	5,000......		...	3	3½	4
J......	2,000 to	3,000......		...	3	3½	4
K......	1,000 to	2,000......		...	3	3½	4
L......	500 to	1,000......		...	...	3½	4
M......	Less than	500......		...	...	3½	4
Where only credit rating appears....				1	2	3	4

In many cases it is found impossible to assign both a capital and credit rating, even though the subject pays bills promptly and is recognized as having a certain credit standing in the business community. Very often it is thus necessary to leave the capital blank, assigning a credit rating. It will to some extent reflect the amount of credit which might reasonably be extended on the basis of all the contributing evidence. Sometimes concerns can not be rated as to capital or credit. The lack of a rating does not always mean that the subject is absolutely without capital or credit, though it does indicate that the business is not well established.

Form of Report.—Agency reports, in general, cover the following heads: financial condition, trade opinions, antecedents, fire record, general remarks. Under *Financial Condition* all data having a bearing upon the financial condition of the subject, volume, and prospects of his business are recorded. *Trade Opinions* includes detail secured from houses with which the individual has carried on business, giving data as to length

of time the account has been sold, amount of credit, terms, manner of payment, limit placed upon the account and whether the subject resorts to any unfair practice such as making short payments or deducting unearned discounts. The *Antecedent* paragraph furnishes a tabloid history of the business, date of commencement, name of predecessor, business history, and other interests of the partners or of officers and directors, if a corporation. *Fire Record* indicates if the subject has ever had a fire, giving date, amount of loss, insurance, cause, and whether settlement was amicably made with insurance companies. *General Remarks* sets forth all data not properly included under the former headings, such as general reputation, habits, and business qualifications.

Endeavor is made to have reports written in simple language, using guarded expressions, omitting unnecessary and irrelevant matter and setting forth the essentials in well chosen words from which can be reached at once an intelligent conclusion of the subject's credit standing and a consistent idea of the actual conditions disclosed by the investigation.

The best way to appreciate the various points covered in a mercantile agency report is to examine one of them in detail as actually rendered to subscribers. With that in mind one has been selected and is presented here:

RV
ROE SKIRT COMPANY, THE (INC.) mnfrs. Los Angeles, California.
Los Angeles County.
411 South First St.

JOHN G. ROE, President & Treas.
SAM SMITH, Vice President.
LOUIS LARSON, Secretary.

DIRECTORS: The above officers with John Doe, who is also Assistant Secretary and Assistant Treasurer.

COND 93 10800 April 20th, 1923.

RECORD

Incorporated October 26th, 1922 under California laws, authorized capital $100,000 in $100 shares. Succeeded to the business of Sam Smith

on November 4th, 1922 in exchange for which he received $10,000 worth of stock in the corporation and $15,000 worth of stock was issued to John G. Roe, $10,000 of the stock issued and claimed paid in cash and the stock, fixtures and equipment of Smith's business. Hold a ten year lease on the premises dating from August 1st, 1922. Smith is aged 36, married, and established the business in July 1920 having come from Milpates, Ky., where he was employed in the same line, is a practical man in this line and antecedent information is favorable.

John G. Roe was previously for thirty-two years with the Slipton Skirt Co., of Newmonia, Conn., latterly as Vice President and still holds stock in that company. Antecedent information is of a favorable nature, to the effect that he owned residence property there, which he sold for $17,000 and had been in receipt of a very large salary and considered as very capable in his line.

Louis Larson is middle aged, married and of B. D. Larson Co. of Newmonia, Conn. Antecedent information is also of a favorable nature and to the effect that a son was associated with him as Larson & Company, automobile agency, which has been discontinued. He was formerly employed as a salesman for a local wholesale grocery concern and of good business ability.

John Doe was district salesmanager for the Never Shrink Skirt Co., managing their branch at Calabasas, Fla.

Statements

John G. Roe was interviewed November 10th, 1922 and while not in a position to furnish a detailed statement, claimed that $40,000 has been paid in, about 50% represented by the investment in the business and the balance cash in bank. Monthly rental $250., a sublet for $175., making rental $75. a month. Insurance on merchandise and fixtures, $15,000, also employer's liability insurance.

The following is a copy of a signed statement received by mail December 6th, 1922 representing the financial condition of the corporation as per inventory of November 1st, 1921:—

Assets:	
Cash in bank	$18,036.33
Accounts Receivable	6,552,79
Bills Receivable	1,489.71
Merchandise	8,714.86
Prepaid Rent	306.00
Other Assets	173.86

Deferred Charges:		
Unexpired Insurance		$ 258.94
Interest paid in Advance		20.82
Fixed Assets:		
Incorporation Expenses		300.00
Furniture and Fixtures		1,052.10
Plant, machinery and equipment		17,439.31
Good-will		5,000.00
Total assets		$59,374,72
LIABILITIES:		
Accounts Payable	$ 6,165.13	
Bills Payable	12,942.57	
Other Liabilities	267.02	
Capital, authorized $100,000		
Capital, issued 60,000		
Capital subscribed and paid in	40,000.00	$59,374.72

Insurance on merchandise $8,000.00 On buildings $15,000

General Information

The statement was accepted as a correct book showing, the cash claimed was fully confirmed, although the furniture, fixtures, machinery and equipment in the opinion of authorities might be subject to some depreciation as a basis for credit and the goodwill is necessarily eliminated, leaving a conservative tangible net worth of approximately $25,000.

Those concerned are in good general repute, give the business close attention and the company is credited with making some progress, having a well-equipped plant.

Trade Reports

HC	Owe	Terms	Pays
3,000	1,900	70 days	Promptly
1,000	1,000	70 days	Promptly
743		2/10/60	Slow 10 days, to prompt
			Sold from March to July 1922
47	47		New account

Fire Record

Not known to have ever suffered a fire loss.

T.11-14-23. E

Nature of Service Rendered.—A commercial agency is merely a collector of information, its function being to report conditions as ascertained from posted authorities and not to give advice, or offer opinions as based on personal knowledge. While appearing as the enemy of dishonest traders, it strives to act as a conserver of solvency, and, so far as possible, to protect equally the interests of reputable merchants and those extending credit. The correctness of information is not guaranteed, but is submitted, without prejudice, as the honest result of honest investigation.

The discussion of the organization and the plan of operation indicate the aim of the agencies in their work. That they do succeed fairly well is shown by the statistics of one of the agencies which shows that of the 411,348 business failures in the past thirty years this company printed 89⅓% with very moderate or no credit, 9⅓% with shaded credit, while the cases actually in error during that period amounted to 1⅓%. In each of the fourteen years prior to and including 1900 this percentage of error amounted to 1% or over, reaching 3⅕% in the panic year of 1893. The only years in which the error has since reached 1% were 1903 with 1⅗%, and 1907 with 1⅕%. The past four years show respectively: ⅘, ⅗, ⅖ and ⅕ of 1%.

It should be noted, however, that these figures are more important from the standpoint of agency efficiency than from the point of view of a student or junior credit man. The credit analyst should himself analyze the information and be trained to arrive at correct conclusions as to ratings and credit limits regardless of percentage arguments in support of agency ratings. It often happens that a firm with a high rating begins to go down hill. Later the credit rating is revised downward. At the time of failure the ratings were probably in accord with the status of the company. The real damage happened when the high ratings were an indication of the past rather than a

prognostication of the future. Perhaps the high rating, having been made a month or six weeks before was not even true as to the present.

The Improvement of Agency Service.—That the agency does not do all that is expected of it is evidenced by the many discussions that take place at the National Association meetings, local association meetings and in the publications of credit men generally throughout the country. On the other hand, that there is a real spirit of cooperation is shown by the fact that the credit men's associations have a standing committee which is intended to aid in the development of a better service on the part of the mercantile agency. In the report of the mercantile agency committee of the National Association of Credit Men reporting to the 28th Annual Convention many of these points were summarized in a splendid way.

> a. The agencies should set a higher standard, devoting special attention to the quality of their reports rather than the quantity.
>
> b. The reporter should be thoroughly schooled, for his work is specialized, and without the proper training, he is not equipped to perform his duties efficiently. The complaint is general with the agencies that they are unable to secure men of the right calibre for their reportorial departments. Under the circumstances it would undoubtedly prove helpful if each agency established a central school and systematically trained its "green" material.
>
> c. The reporter seeks only ledger experience in his interviews with authorities and he would be in a position to write a more dependable report if he would ask the following questions regarding one whose standing was being looked up:
>
> 1. Is he of good character and habits?
> 2. Is he a capable manager and attentive to business?
> 3. Does he appear to be making financial headway?
> 4. Have you any unfavorable criticisms to make regarding his methods?
>
> d. The agencies should ask in a determined manner for full cooperation from subscribers, providing on the face of their in-

quiry tickets, a form for the experience of the subscriber or other data of import to them, and include a clause in their subscription agreements requiring that this information be furnished.

e. The dependability of reports varies in the different districts but the agencies should require all reports to measure up to a high standard by a strict system of censorship. The result would be to eliminate the many worthless reports which are formulated by small branch offices or by traveling reporters and correspondents. The most reliable report is written by the reporter in a large city who interviews the subject of his investigation and the authorities who are extending credit.

f. No capital rating should be given to any concern that refuses to make a financial statement.

g. The agencies should seek advice as to the habits of merchants in connection with deducting unearned cash discounts, cancellation of orders and returning goods, and incorporate the information in the reports.

h. The written inquiries of the agencies should be answered by credit grantors the same day they are received, and in detail. It is not sufficient simply to write on the form "satisfactory account." Verbal requests for information by the reporter should be answered freely and without a tendency to withhold unfavorable facts.

i. In making an inquiry, care should be exercised to write the name, street address and city correctly and plainly. The subscriber should furnish the agency with his experience with the subject of the inquiry, or with references if he has received any in the case of an initial order.

j. If the subscriber notices any discrepancy in the report or incorrect information, he should immediately notify the agency, giving complete details. In all cases where the report is incomplete, it should be returned with a request for the missing data. The subscriber should pass along to the agencies all information which comes into his possession which would change the tenor of a rating and notify them in all cases where he has placed in the hands of attorneys, accounts regarding which there is no legitimate dispute.

k. Subscribers should suggest to their customers the making of financial statements to the agencies.

l. It is possible for the mercantile agencies to furnish reports which will answer the requirements of the credit department if

> they will inject thoroughness into their service and ask for and insist upon getting the full cooperation of subscribers. If efficient mercantile agency service requires an increase in present rates, your committee is certain that subscribers will willingly pay more if assured of really better reports.
>
> If the agencies would get a new inspiration and place the standard of their service on the highest pinnacle, and if the subscribers would pass along to the agencies when making the initial inquiry, references received from the customer when he places his order, and then acquaint the agencies with any facts developed by their own experience with the customer or otherwise obtained, which would have a bearing on the rating which has been assigned, the results would be most gratifying and mutually beneficial. The agencies would receive increased business; the credit department would receive the information it requires and the latter would be saved the time and expense of securing through other sources the data now felt to be necessary to supplement many of the present type of reports in order to make possible the application of intelligent judgment as to the desirability of the risk.

The Mercantile Agency and Its Subscribers.—There are obligations on both sides of an agency relationship. The subscribers to an agency have responsibilities. In the first place, the duty of interpretation of a report belongs to the subscriber. In the second place, subscribers ought to return defective and poorly compiled reports to the issuing office. In the third place, subscribers themselves could furnish much valuable information concerning accounts which are unsatisfactory.[2]

It is essential to use the same care in requesting a report from the agency that would be used in sending a house representative out on a personal investigation—that is, to take the precaution of giving adequate information that will remove all question as to the identity of the subject under consideration. To do this satisfactorily, the inquiry ticket should include the name of the individual, firm or corporation upon

[2] Thomas, J. S., *Mercantile Agency Service* in Credit Monthly, March, 1923.

whom a report is desired and if possible, the street location; the business occupation; the post office and state; and the name of the person requesting information. It is advisable to state on the back of the ticket of inquiry what information is desired or any particular features upon which further information is requested. The names and addresses of those who have sold the subject of inquiry may aid further in positive identification and the securing of more accurate information.

The Mercantile Agencies Service Committee has emphasized, for the purpose of securing better agency reports to customers, the four following points:

1. The indispensable value to subscribers of good, honest, intelligent, reportorial work.
2. The necessity of censoring reports before they are issued.
3. The lack of appreciation in some of the districts or local offices of the nature of the work.
4. The exercise of proper care in the compilation of ledger space. Particularly was it emphasized in this connection that if the agents are to develop satisfactorily the ledger interchange feature of their reports, they must work out plans for obtaining the information that will not overburden credit departments or secure merely incomplete or undependable information.

The position of the agency has been well established in supreme court decisions as follows:

RIGHTS OF A MERCANTILE AGENCY TO FURNISH INFORMATION

What a man may lawfully do by himself he may do by an agent. Beardsley vs. Tappan, 5 Blatchford 49. The Mercantile Agency is the Agent of him who engages it to serve him. Information of the description referred to (Mercantile Agency) being important, there is no legal objection to the employment of an Agent to seek and communicate it.

We may well say, as did Joseph W. Errant thirty-three years ago:

> Thus the Commercial Agencies, which were at first regarded as partaking of the nature of a system of espionage seemingly at variance with that candor and love of open dealing so characteristic of our commercial usages, have gained the confidence of the commercial world, and have demonstrated by their careful and successful management, that they are necessary parts of the machinery of trade and commerce.

Particular Field of the Special Agency.—The mercantile agency had a great deal to do with developing the custom of imparting information pertaining to credit. Business men began to feel that an exchange of confidence did contribute to better business and that a man might be a vigorous rival and still give credit information without interfering with the success of his house. The general agency covering as it does the entire commercial world, must necessarily consume time in its work and prepare its reports in advance, hoping to keep on its books complete information concerning the large majority of debtors of the particular area involved so that, at any time information is called for, it will be available for use. The general agency has tremendous power but not much speed. The organization attempts to anticipate inquiries. Newly created conditions are unknown and credit information cannot always be secured. It is expensive to revise reports and it is desirable that one report should be sold several times in order that a profit may be made. This situation has brought into the field many small agencies equipped to give special service under particular circumstances or to particular subscribing organizations. One of the important features of the special agency is that its reports contain a larger number of ledger facts, and credit men of the day are beginning to realize the importance of the story told by an examination of the ledger record. The special agencies have operated ordinarily in a limited territory and have often specialized on a few lines of industries. Sometimes one individual goes into the business

of furnishing reports at a price. In other cases, companies are organized on a fairly large scale with the idea of making immediate personal investigations. As a rule, the special trade agencies make a finer division of credit and capital ratings than do the general agencies. They frequently include a third or "pay" rating.

References

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CHAPTER IX

LEDGER INTERCHANGE

Cooperative Use of the Records in the Open Book Account.—When the credit manager extends credit he should be fairly certain that the risk is good and that the account will be paid. He may have had previous experience with the customer and found that he pays promptly. Mercantile agencies may be returning favorable reports upon the customer as to his ability to meet his bills when due. But the credit manager has still another source of information open to him—a source which gives to him an accurate representation of the customer's methods of meeting his current obligations; namely, the examination of the open book account.

The open book account of a debtor in the office of one creditor gives, however, only a part of the information concerning him. One record of the debtor's paying habits is not enough. A larger field of observation is opened to the credit manager by the cooperative use of the records in the open book account, or, in other words, the interchange of ledger experience. Thus, if the accounts of a dozen creditors are made available to each credit manager, the general paying habits of the debtor are opened for inspection.

Advantages of information so obtained are obvious. It is of more recent date than most of that compiled by mercantile agencies, whose reports cover mainly financial statements and the debtor's character and reputation. Moreover, information secured through ledger interchange is particularly dependable as the actual and current activities of the debtor are laid before the credit manager for analysis.

Ledger interchange is, for these reasons, assuming a posi-

tion of ever-increasing importance as a sound basis for credit analysis. The fact that the American business man is broad enough in view to appreciate the advantages of an open and free exchange of ledger experience is a sign which lends optimism to future business development..

Paying Habits as an Indication of Credit Strength.—By analyzing the paying habits of customers the credit manager is able to ascertain their methods of doing business, and in just what manner these methods react favorably or unfavorably upon their credit strength. In order to emphasize the significance of prompt paying habits it is only necessary to figure the value of money to the concern in its daily turnover in contrast with the value when tied up in accounts receivable.

Classification of Methods of Ledger Interchange.—Two general methods of obtaining information concerning a trader's business habits and procedure are open to merchants, manufacturers, and jobbers,—the direct and indirect methods. Under direct methods may be listed:

1. Individual conversation
2. Meetings of trade groups
3. The special investigator
4. The written inquiry plan.

Indirect methods include:

1. Trade opinions from general agencies
2. Local association credit interchange
3. National Association of Ledger Interchange
4. Trade organization credit bureaus
5. The Credit Clearing House

Individual Conversation.—A business man, desiring ledger information concerning a certain present or future

customer, might naturally turn to the credit managers who have already had experience with the subject of investigation. At first sight this appears to be a feasible and straightforward method of obtaining information. However, it has two rather obvious disadvantages. First, it often serves as the originating factor in a great many investigations—falling perhaps, upon the credit risk at a time when he is especially in need of his creditors' confidence. Secondly, it causes duplication of effort, and is inefficient in that far too much of the credit manager's time and energy may easily be consumed in securing and giving information in this manner.

Meetings of Trade Groups.—A method of direct ledger interchange which involves conversation but has many advantages over the method just described is the trade group meeting. Credit managers, their representatives, or members of local credit men's associations come together for regular meetings, once or twice a month, or even weekly, for the purpose of exchanging ledger experience and other facts of value in making credit decisions.

In cities where a number of local credit men's associations are organized those interested in similar or related lines of trade meet together. For instance, the creditors desiring information on buyers of food-stuffs have one group; those wishing information on buyers of clothing another, and so on. The number of trade group organizations usually varies with the size of the city.

At these meetings information is both given and secured regarding the paying habits of common customers, the advisability of extending new lines of credit, and other facts which may in any way affect the interests of the creditors. Different methods for exchanging this information are employed. The members of the group may give to the chairman of the meeting the names of those about whom they wish in-

formation. These names are then read and anyone possessing information of value and reliability shares it with his fellow members. Sometimes the members are given numbers by which to report.

Whatever the method employed, the good features of such direct interchange are causing its increasing use. The dependability of the information, the up-to-date nature of the facts exchanged, and the directness of the method which makes possible quick decisions are all in its favor. A fourth advantage, that of increasing cooperation among credit men, is developed in a later chapter.

The Special Investigator.—Credit managers in banks and in a large number of commercial houses employ a special investigator, one of whose functions it is to aid in the gathering of ledger information. The investigator, by means of calls and direct conversations, attempts to secure from credit grantors ledger experiences and other facts bearing upon the subject of his inquiry. The duties and methods of these investigators may either be outlined by credit managers or developed through the initiative and resourcefulness of the investigator himself.

The information which the special investigator is desirous of obtaining generally includes the age of the account; the paying habits which it reveals; its current condition; the highest credit granted; trade abuses practised, if any; and the type of men responsible for the financial success of the business.

The Written Inquiry Plan.—The credit manager, through his investigation of his customer, generally ascertains what firms are the other creditors of his customer. References, names of other creditors, the personal interview, give this information. The traveling salesman of the house can indicate companies from which the debtor is buying if he examines the trade-marks of the goods on the shelves of the buyer. In cer-

Philadelphia, Pa.................... 192

WE GIVE YOU BELOW OUR EXPERIENCE WITH

Name ....Business ....

P. O. ....

From whom we have....................order for $.........
(indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND ADOPTED BY
NATIONAL ASSOCIATION OF CREDIT MEN

.... COMPANY

To ______________________________

____

		Manner of Payment Answer—Yes or No
Sold since....................To..		
Terms.............................	.....	Discounts
Largest amount owing recently $...	.....	Prompt and satisfactory
Total amount now owing...... $...	.....	Slow but collectible
Amount past due .... $...	.....	Slow and unsatisfactory
Other information.................	.....	Days slow
....	.....	Accepts C. O. D.'s promptly
....	.....	Settles by Trade Acceptances
....	.....	Account secured
....	.....	Notes paid at maturity
....	.....	Makes unjust claims
....	.....	Collected by attorney

RETAIN THIS FOR YOUR FILES

GIVE YOUR EXPERIENCE ON ATTACHED SLIP

Figure 7a. Ledger Interchange Form (face)

THE OBLIGATIONS OF THE MAKER AND RECEIVER OF AN INQUIRY IN THE INTERCHANGE OF CREDIT INFORMATION

When one credit department asks another to detail its experience with a certain buyer, we have a delicate situation around which must be thrown well understood safeguards.

The inquiring department should observe the following general rules:

1. It must know that the making of the inquiry is necessary, for indiscriminate making of credit inquiries hurts the credit interchange system because it develops unnecessary labor. The inquirer, therefore, must be reasonably certain that the party inquired of has something to contribute which shall bear upon the risk in question.

2. The inquiry must be made on an order in hand or a ledger account. The making of inquiries on prospective customers when the inquirer explains or omits to explain that he has no order or experience but is merely endeavoring to size up the desirability of a buyer, leads to restless complaint against the interchange system.

3. The inquirer must accompany his inquiry with an accurate explanation of the reason for making it and also give his experience with the account. If the inquiry is made on a first order, he must so state, with the amount of the order. The making of inquiries without the disclosure of the inquirer's exact experience has created in the minds of some credit men a disinclination to interchange with credit departments.

On the other hand the credit department inquired of should observe generally the following:

1. Give its exact experience, to fall short of which is to hurt the interchange system and direct a blow at a tremendously important institution in modern day business.

2. Place the duty of answering inquiries in responsible hands and not leave it to unqualified assistants who are indifferent to the importance of the system.

3. Inform the inquirer whenever he has failed to carry out his part under the interchange system, this being necessary to correct the faults and abuses which some through carelessness, others through blind obstinacy, have imposed upon interchange. Merely to ignore faults and abuses gets us nowhere.

The Officers and Directors of the National Association of Credit Men urge the importance of the observance of these general lines of action on the part of the receiver and giver of credit information to the end that the system may do its best work and contribute to that safe clearance of risks which every credit department should, for the good of itself and all, work consistently to support.

A stamped addressed envelope should accompany the inquiry

Figure 7b. Ledger Interchance Form (back)

tain trade areas one can almost be certain that a customer buys from particular houses in certain lines of merchandise.

Sometimes it is found to be good practice to secure ledger interchange direct from other members of the Credit Men's Association. The National Association of Credit Men has adopted a special form for the purpose of getting information direct from another house. A sample is shown in Figure 7 a and b.

In many cases it will be found necessary to write special letters to fit particular situations in order to get the information desired. A credit letter carefully formulated, giving as well as asking information, is generally kindly received and courteously answered by the credit managers of the present time.

Indirect Methods of Ledger Interchange.—During the last fifteen years the method of exchanging ledger experience through central bureaus has had an amazing growth. Some of the limitations and disadvantages of direct interchange are overcome, and, as the efficiency of these bureaus increases with the centralization on information, the reports become more valuable and more up-to-date.

Trade Opinions from General Agencies.—Included in the general agency reports, such as Dun's and Bradstreet's, is a section on trade opinions in which the agency attempts to give to the inquiring creditor the opinions of other firms regarding the paying habits of the customer in question. This phase of the general agency report has been criticized in the past because it was often incomplete and did not contain figures covering frequent enough intervals. The Dun organization, within the past two years, has emphasized the work of its Trade Report Department in an effort to give out recent trade opinions to its customers. Figure 8 illustrates the inquiry used by Dun's in

gathering its information. The general agencies serve the credit manager as one of the indirect methods available to him in securing ledger information.

THE MERCANTILE AGENCY

R. G. DUN & Co.

Trade Experience Inquiry

ON

Please state your experience with this trader, who may or may not have referred to you. A PROMPT answer will be appreciated.

HIGH CR. $........... ORDER $...............

OWES : : $...........TERMS.................

PAST DUE $...........SOLD { From............ To.............. } (last sale)

PAYS { ☐ANTICIPATES ☐DISCOUNTS ☐PROMPT ☐SLOW.........................DAYS }

☐Pays on Account	☐Asks Extensions
☐Pays by Note	☐Collected by Attorney
☐Repudiates Contracts	☐Takes Discounts Unfairly
☐Returns Goods Unjustly	☐Makes Unjust Claims
Refused............	Cause..............☐

....☐

Office and Sub Number

Figure 8. Trade Inquiry Report

Local Association Credit Interchange.—The membership of the credit exchange bureau is limited to manufacturers, wholesalers, jobbers and bankers. Each member files with the

bureau a list of his current accounts—accounts of business firms, not of individuals. Each member is given a distinctive number to be used in his reports. The Buchanan Shoe Company for instance, might carry the number 372. A master card is made out for each customer, and on this card is affixed the number assigned to each member having dealings with the customer. For instance, if the J. P. Smith Dry Goods Company were a customer both of the Buchanan Shoe Company,

J. P. SMITH DRY GOODS CO.,

CHICAGO, ILLINOIS.

372
373

Figure 9. Master Card

No. 372, and of the Torrance Shoe Company, No. 373, the card of J. P. Smith Dry Goods Company as shown in Figure 9. would carry both the numbers 372 and 373. If the J. P. Smith Dry Goods Company is buying from ten firms which are members of the Exchange, its card will have ten different numbers on it. The cards of the customers are consolidated into the customers' list card file.

If at any time a member wishes credit information concerning a new customer, he sends his request by telephone or

FORM F INTERCHANGE BUREAU

THE NEW YORK CREDIT MEN'S ASSOCIATION

No............. *Date....................*

Name ....

Address ....

Tear Off Here

FORM F

SUBSCRIBER'S INQUIRY TICKET

Member's Inquiry No..... *Date..............*

THE NEW YORK CREDIT MEN'S ASSOCIATION

INTERCHANGE BUREAU

320 Broadway Telephone: Worth 7670 7672
7671 7673

Name ....

Street No..................................

Town ....

Business ....

Also uses style............................

Am't unfilled

How long sold.........order or contract.........

(Dollars only)

Highest credit past year........................

(Dollars only)

Owing *Ledger......Amount now past due......*

Notes...........How Long...........

(Dollars only)

Date of last sale ....

(Month and Year)

Terms of Sale..........Manner Payment........

Is buying from (Local References only.)

....

....

Subscriber's Signature.......................

Member's No...................................

Figure 10a. Subscriber's Inquiry Ticket

KINDLY FILL IN YOUR EXPERIENCE AND SEND TO US BY RETURN MAIL

Form SRS

SUBSCRIBER'S REPLY SHEET
NEW YORK CREDIT MEN'S ASSOCIATION
320 BROADWAY

INTERCHANGE BUREAU

Following is our ledger experience on debtor named below.

Name Address

MANNER OF PAYMENT

Indicate "Manner of Payment" in column below by figures.

1. Discounts
2. Pays when due
3. No.________days slow
4. Slow but considered good
5. Settles by notes
6. Pays notes when due
7. Slow and unsatisfactory
8. Settles with Trade Acceptance
9. Pays acceptances when due
10. Makes unjust claims
11. Takes unearned discounts
12. Refuses to pay interest
13. Pays draft
14. Don't pay draft
15. Account now in attorney's hands
16. Collected by attorney

SPECIAL REMARKS

Indicate "Special Remarks" in column below by letters

A. Pays according to agreement
B. Neglects to accept shipment on arrival
C. Carries out contract
D. Asks extensions of contracts
E. Asks for cancellations
F. Makes cancellations
G. Asks postponement of delivery
H. In market for quick delivery

TERMS OF SALE

CIA —Cash in Advance
COD—Cash on Delivery
CAD —Cash against Documents
SDBL—Sight Draft against Bill of Lading
(Indicate the above or other terms in "Terms of Sale Column" below)

How Long Sold Mo. & Yr.	Highest Credit in Past year Dollars only	Amount Owing Dollars only	Amount now Past Due Dollars only	How Long Past Due	Date of Last Sale Mo. & Yr.	Manner of Payment (use fig)	Terms of Sale	Am't Unfilled Order or Contract Dollars only	Notes or Trade Accept. Dollars only	Date of Expiration of Contract Mo. & Yr.	Special Remarks (Use Let.)

Additional information..

....

SEND IN YOUR REPLIES BY RETURN MAIL. To maintain the efficiency of the Bureau PROMPT co-operation by members is absolutely necessary. Information received later than three days after original report is issued cannot be added to reciprocal reports.

Please list on reverse side of this sheet names and addresses of houses, not members of the Bureau, which you believe to be interested in this account.

Member's No. ....

Figure 10b. Subscriber's Reply Sheet

by special "Subscriber's inquiry" blank prepared for the purpose, to the central office. The central office looks up the card of that particular customer. If the information about the firm has been revised within the last sixty days, it can at once be sent to the inquirer. If the information is older than sixty days, the central office sends out to each member whose number appears on the customer's card an inquiry blank asking for up-to-date information.

The information called for generally includes the length of time which the subject has been a customer, the terms of sale, the highest recent credit granted, the total amount owing, the amount overdue, the manner of payment, unfilled orders and miscellaneous remarks. A typical inquiry blank is shown in Figure 10.

The member is glad to give the information, because the customer is one with whom he has had business dealings (otherwise his number would not be on the customer's card), and he is sent, free of charge, the completed, up-to-date report on that customer. This "reciprocal" plan works to the advantage of the bureau, the inquirers, and also of the members who fill out the inquiry blanks.

As soon as the bureau gets replies from the inquiry sheets sent out to its members it compiles a report without indicating the individual sources of the information and sends to the member who has made the inquiry a complete statement of the ledger experience of all the members of the bureau as reported. The sample report as sent to members of the Bureau is shown in Figure 11.

The value of this kind of report is easily seen. The first column tells the length of time each member has had dealings with the customer. The column "Overdue" is valuable as an index of the customer's paying habits. The relation between "Owing" and "Overdue" shows the proportion of the account

which is past due. The "Manner of Payment" column reflects the satisfaction or dissatisfaction of the creditor, and shows whether the debtor pays on time or makes satisfactory arrangements for payment. This report is not somebody's estimate of the debtor, but is the *actual record* as shown on the books of each creditor reporting.

How Long Sold	Terms	Highest Recent Credit	Owing	Over-due	Manner of Pay & Misc.	Orders Unfilled
long.	reg.	2193	2193	1234	V. slow	
yrs.	reg.	17000	16122	12946	Satisf.	
yrs.	60	1345	520	18	Good	
2 yrs.	2/30	560	232		F. pr.	
yrs.	30d.	1382	1382	1172	V. slow	
		7357	4907	3825	Slow	
yr.	mo.	1000	500	200	Fair	
long	mo.	600	600	270	Fair	
	2/30	4200	4200	2000	6 mos. at int.	
4 yr. 8 mo.		867	867	512	Slow	
yrs.	1st mo.	1972	1678	549	Slow	
		2384	1372	650	Slow	
		5115	4647	4363	Slow	

Figure 11. Sample Report of Credit Interchange Bureau of National Association of Credit Men

The success of a credit exchange bureau depends on two factors: the number of credit men who belong to a bureau, and the cooperation of the members. The larger the membership, the more complete will be the report; and cooperation of the members not only secures more complete information but also more accurate information.

Individual trade associations have developed bureaus of their own, working on a basis similar to that of the credit exchange bureaus. These bureaus exist in all of the larger cities

in the United States, and attempt to serve the needs of the particular trade area involved.

National Association Ledger Interchange.—It is easy to see that a firm doing business in a large number of trade areas would find it very desirable to get information of this kind on a national basis. In other words, it would be desirable in a country where transportation is as well developed as it is in the United States to have interchange bureaus of a national character, clearing information from offices in the different cities. This has been done by the National Association through the central credit interchange bureau at St. Louis.

This bureau is not an office for gathering, tabulating and disseminating information. Its function is to determine which local bureaus are interested in any subject inquired upon; and in addition, to secure unity of action in all the local branches.

Each local bureau determines its zone of direct interest, *i.e.,* the section of the country where the most of its members sell their goods. Then each bureau sends to the Central Bureau a list of all customers who are outside of this zone of direct interest. The name of each customer is placed upon a separate card, and alphabetically filed. This procedure differs from that of the local bureau in that the numbers placed on the card are those assigned to the local bureaus, rather than individual firms.

This is a record, then, of the markets which are interested in, and have had dealings with, each customer. Each participative bureau is given a chart showing clearly the district of direct interest of each local bureau. Suppose an inquiry comes to the manager of a local bureau about a customer not in his zone of direct interest. By his chart he can tell which bureaus are directly interested in the subject's district. He sends a direct inquiry to each bureau in whose district of direct interest the subject of inquiry is located. The manager of each bureau

acts as in the case of any local inquiry, sending blanks to its members who have had dealings with the customer. Each bureau sends its information directly to the bureau which has inquired.

An inquiry blank is sent also to the Central Bureau, in order to clear the subject of inquiry among all the bureaus not directly interested in his district and general market. In handling the blank, the Bureau refers to the customer's card and to the local bureau numbers on it.

By direct inquiry from the interested districts, and by indirect inquiry through the Bureau from districts not directly interested, all information concerning the customer and his dealings in all parts of the country can be secured. The final report is made through the bureau which made the original inquiry, and a copy of it is sent to all bureaus which cooperated in gathering the information.

The various Interchange Bureaus of the National Association of Credit Men have adopted a code for transmitting credit information by telegram where it is essential to get this kind of information before approving an order. For a small additional cost, it is possible, through this means, to secure quickly the experience of others on a given account.

Trade Organization Credit Bureaus.—These bureaus differ from the local Credit Men's Associations in that they attempt to cover more specialized fields, and are therefore organized on a trade basis.

A successful trade bureau acting as a special agency of this type is that of the Building Material Dealers Credit Association of Los Angeles, owned and operated by four hundred building material dealers, banks and bonding companies. The plan embraces a system by means of which complete lists of customers are secured from each member and a card is filed for each customer. Members are identified by numbers.

Customers' cards carry the numbers of all members doing business with them together with other pertinent information. This particular organization has ledger experiences and other credit information on approximately fifty thousand contractors and other individuals and companies using building materials.

Monthly Reports.—In order to keep these listings complete each member turns in a monthly listing report as shown in Figure 12.

MONTHLY LISTING REPORT

B. M. D. C. A.

READ INSTRUCTIONS AND
INFORMATION IN RED BOOK

Member
Name ....No......Los Angeles, Cal., ...192..

FULL NAME	ADDRESS	OCCUPATION	HIGHEST CREDIT	HOW PAID *, 1-2-3, ETC.	REMARKS EXPLAIN "4," "8" AND "9" LISTINGS

Figure 12. Monthly Listing Report

Weekly Reports.—The information already tabulated and that secured by special request from members is then placed in a weekly report and sent to all members interested. A specimen report is shown below:

This report is furnished for the exclusive use of member receiving same and must be treated in strict confidence. Any member violating this confidence is subject to expulsion from the Association.

WEEKLY BULLETIN

B. M. D. C. A.

Confidential — December 4, 1924.

Two Sheets—Sheet No. 1

WEDNESDAY MEETINGS AND INTERCHANGE OF CREDIT INFORMATION

12:00 Noon—City Creamery—11th & Olive—Wednesdays

WHERE ARE THEY?

Members kindly phone office if they have present addresses of parties listed.

B. Caldwell		Formerly	614 Oak Ave., Belle Verne Venice
W. H. Dickson		"	Los Angeles
E. J. Donovan		"	101 San Fernando Bldg.
I. M. Easy	(c)	"	200 Idaho St., Santa Monica
Forrest & Keefe		"	106 W. 20th St.
T. H. Jenks	(cp)	"	Burbank
Roy Larsen	(plc)	"	Lankershim

MEMBERSHIP

APPLICATION:

The following application will be voted on by the Board of Directors next Wednesday. Any members who have credit information concerning him please communicate same to office at once.

T. B. Bankrupt Merchant Plumber 121 E. Vernon Ave.

CHANGES:

No. 697—The Dexter Co. Address to: 1160 San Pedro St.

"S" LISTINGS TO BE PASSED ON BY BOARD NEXT WEDNESDAY UNLESS OBJECTIONS ARE FILED

Basket, Robt.		140 Orange Grove
Catalina Mfg. Co.		1110 San Fernando Rd.
Cass, Jos.	(plc)	14 Edgement St.
Doolittle, H.	(c)	100 New Depot St.
U. R. Raspberry	(cc)	Hollywood Blvd.

GENERAL INFORMATION

(a) Levy, Charles E. —Bankrupt 6/30/24. Has published Trade Style as Eager Mfg. Co.

(b) Smith, Jas.—"8" —Incorporated Nov. 29th as "Jas. Smith, Inc." Cap. Stock $150,000.

(c) Parker & Jones —On and after Dec. 1, 1924 this company will

be consolidated with and known as the P. R. Rice Co., of Chicago, successor to Parker & Jones.

(d) Phillips, Wm., Co.—Office is advised by Martin E. Lewis, Atty., 203 Bank of Italy Bldg., that he has prepared a Creditors' Agreement for adjustment of this company's accounts, and is holding same in his office for creditors to inspect and sign if agreeable. Mr. Lewis states that assets will pay about fifty cents on the dollar of the Wm. Phillips Co. claims.

N. S. F. Checks Given by:

Dunlap Motor Co.	Glendale	$14.01
Biograph Pictures Corp.	Corporation Bldg.,	50.00
Arthur A. Ross	600 N. Virgil	20.00
M. A. Blank	400 S. Main	8.25

Warning to Members—Bad Checks:

It is reported that 110 blank checks of Roberts, Little & Black (firm out of existence) on State National Bank were stolen from Office of Little & Black on Friday last. Eight checks presented so far at bank made out to James Madison; also we have report that checks of Little & Black, numbers 2189 to 2200, were stolen three weeks ago. If presented hold parties and notify police. A member reports check given by Lester Ellis signed Ross Blake $5.70. Fictitious address. No account under either name.

Weekly Bulletin
B. M. D. C. A.

Confidential December 4, 1924.

Two Sheets—Sheet No. 2

With the monthly statements of dues mailed yesterday, there was sent to all active members of the Association a ballot for the purpose of voting on new Directors to serve for a two year period. Members are requested to fill out ballot as soon as received and immediately mail to Association Office as per instructions enclosed with ballot. This Is Important. Please Do It Now.

Collections

We are now approaching the end of the year and in clearing up old accounts, members will undoubtedly find the ASSOCIATION COLLECTION DRAFTS FOR OVERDUE ACCOUNTS of assistance. They are an inexpensive form of collection service.

SPECIAL REPORTS: Phone Office if you desire copy.

#818—R. P. Levensen	(cb)	1222 Willoughby Ave.
#819—Bigelow & Son	(cb)	1004 W. Washington St.
#820—Howard Vanderberg	(cb)	Res. 201 Barton Ave.
#821—Brown & Wright	(re-c)	100 Metropolitan Bldg.
#822—White Truck Co.	(cb)	1008 W. 8th St.
#823—Ross Bldg. Co. (Not Inc.)	(c)	Hollywood Blvd.
#198—G. R. Basso (Rev.)	(bc)	1288 W. 11th St.

LIEN: We are advised following lien does not reflect on contractors named.
Wilcox & Feathers—on Zimmerman Job 11-21-24 FILED BY #519

BANKRUPTS:

Reader & Hill, Long Beach	Lia.	$61,836	Assets	$9,126
H. R. Moore, Long Beach	"	21,066	"	9,700
P. E. Ritchey (involuntary)				
B. E. Harwell, Los Angeles	"	4,547	"	1,700

BILL OF SALE:

Sawyer Paint Co., 6000 So. L. A. St.—Sale & Agreement Wm. Wells to Roger R. Grow.

Wm. M. Pointer to R. S. Behr, Tr.—All machinery, etc., of L. O. Glover in factory on Motor Ave., Palms, Calif.

HOMESTEAD FILED BY:

Wallace A. and Grace P. Chase—Portion Lot 23, Block D, North Elysian Heights.

CHATTEL MORTGAGES:

Hill & Marion E. Carter to City Creamery Co.—Personal Property

City Cement & Gravel Co. et al to Wm. A. Eaton and P. L. Hammon—Personal Property

John & Ruth Moore to H. P. Smithers—Furniture & Furnishings

Brown Bldg. Mat'ls Corp. to S. M. Small—Office Equipment

ATTACHMENTS:

Earl O. Gump by Santa Monica Hdwd Co.	Lot 42, Tract 7195
Roger I. Laskey by Reader Hdwd Co.	Lot 85, Tract 5234
P. O. Johnson by R. E. Blossom	Lot 22, Block 22, Tract 4948
J. McDonald by G. Greene	Part Lot 20, Block 36, Pasadena Heights Tract
P. G. Sears by R. E. Blossom	Part Lot 10, R 9, Alhambra Add'n.

JUDGMENTS:

Carson Development Co.	$228	California Distributors Co. Possession	$700
J. L. Crump	94	P. Q. Lawrence	1500
Western Film Co.	25	Independent Petroleum Corp., etc.	4900
Walter Courtney	52	Robert I. Edwards *et al*	50
Victor Hyden	374		
Chas. V. Sims *et al*	650		

Bi-monthly and Yearly Reports.—Adverse listings and unfavorable factors in connection with the customers' accounts are furnished members of these trade organizations at regular intervals. Various methods are employed in furnishing members this adverse information. Some furnish their members with typewritten or mimeographed sheets; others send out printed booklets; still others publish this information in their trade publications. It is a feature that must, however, be very tactfully handled in order to avoid possiblity of damage suits.

These trade organization bureaus use various means of putting into the hands of subscribers each year up to date listings and ratings of customers whose names have been the subject of inquiry during the year. Some publish these lists in book form; some merely employ loose sheets for binders. A sample section taken from one of these books follows:

Fleming, John Emerson, Secty.	11-5-8
Fleming, John E., lithographer	11-6-8
Fleming, John J., draftsman	11-5-8
Fleming, John J., undertaker	11-5-8
Fleming, Mrs. John P.,	5-8
Fleming, Jos., pipe fitter	11-6-8

The various symbols following the names shown above indicate the degree of dependence that may be placed on the credit risk:

1 – Prompt pay.
2 – Medium prompt pay, occasionally slow.

3 – Slow pay.
4 – Very slow and irregular.
5 – Good risk.
6 – Fair risk.
7 – Moral basis only.
8 – For a moderate credit.
9 – Reports indicate bad pay.
10 – Reports advise cash dealings.
11 – Has fair income.
11X– Has good income.
12 – Income irregular.
12X– Reputed to possess means.
13 – Coupon received from collection system.
14 – Honest, but resources small.
15 – Owns residence, apparently clear.
16 – Owns residence, encumbered.
17 – Rents residence.
18 – Owns real estate.
19 – Last known address.
19X– Real estate encumbered.
20 – Character good.
21 – Character fair.
22 – Character bad.
23 – Habits good.
24 – Habits fair.
25 – Habits bad.
26 – Legally responsible.
27 – Claims have been placed for collection.
28 – One or more judgments heretofore recorded.
29 – Moves frequently.
30 – Special report advised.
31 – Money at interest.
32 – Nothing tangible upon which to base credit.
33 – Usually pays cash.
34 – Money left in trust.
35 – Judgment before magistrate.
36 – Account closed for cause.
T – No means outside salary.

EXAMPLE:

Fleming, John Emerson, Secty. 11-5-8.
(11) Has fair income.
(5) Good risk.
(8) For a moderate credit.

REQUEST FOR PROPERTY SEARCH, AND REPORT
RECEIVED FROM TITLE COMPANY

Nº 25700

A CHECK MARK "✓" MEANS NO CHANGE FROM INFORMATION GIVEN IN THE INQUIRY

DATE

MEMBER BY

	INQ. RPT.	
LOT BLOCK	BOOK	LOT BLOCK
TRACT		TRACT
	PAGE	
STREET ADDRESS		RECORD OWNER
REPUTED OWNER	Ref.	
		DATE DEED REF.

IF NOTHING APPEARS ON RECORD INDICATE HERE

ENCUMBRANCES AND ITEMS ON RECORD

Mtge. $	favor	date ref.
Mtge. $	favor	date ref
T. D. $	to	as trustee in favor of
		date ref.
T. D. $	to	as trustee in favor of
		date ref.
MECHANIC LIEN BY		date ref.
		date ref.
		date ref.
		date ref.
		date ref.
		date ref.
ATTACHMENT BY		date ref.
HOMESTEAD BY		date ref.
ASSIGNMENT OF MTGE.		date ref
BLDG. CONTR.	NOTICE COMP	NOTICE NON RESP

OTHER ENCUMBRANCES OR MATTERS OF RECORD

Figure 13. Request for Property Search

Other Work of the Trade Bureau.—The special reason for the existencc of trade bureaus is seen in Figure 13, which illustrates the need for particular types of information:

Another feature of some of these organizations is weekly or bi-weekly luncheons where members gather, and on the basis of their identification numbers exchange credit information, all of which goes into the files for later use.

These bureaus are continually at work on special reports and financial statements, including complete detailed investigation concerning certain accounts. They cooperate in giving and securing information from similar organizations in other cities, in addition to publishing circulars of various forms containing information of general interest.

These organizations also aid other members in collecting accounts when the members desire to take advantage of this service. Figure 14 shows the form of a letter enclosing a collection draft, sent out by one local credit association. Around the border of the letter-head are printed the names of the firms belonging to the association. The psychological effect of receiving such a letter is apparent.

Credit Clearing House.—The Credit Clearing House is a national organization under private management operating in the interest of wholesalers and manufacturers. It has offices in all of the principal trade centers. The Credit Clearing House has two separate functions; it is (1) A credit checking service, and (2) A collection service.

In the performance of its function as a credit checking service, it is distinctly different from other credit organizations. It furnishes neither ratings nor reports. It does furnish recommendations which recommendations apply to specific orders only; that is to say, a member makes an inquiry regarding a specific order, stating the specific amount involved, whether anything is owing at the time the inquiry is made, and

ORVILLE W. JONES, President LEONARD W. COVERT, 1st Vice President CHARLES D. COLLOM, 2nd Vice President GLEN BEHYMER, Association Attorney

Members

Acme Contractors
Acme White Ld. & Col. Wks.
Advance Lumber Co.
Aggressive Sales Co.
Alley Bros. Lumber Co.
American Door Co.
Am. Gas Appliance Co.
American Lumber Co.
Am. Dry Color Co.
American Wall Paper & Paint Co.
Am. Sys. of Reinforcing
Angelus Roof Paper & Pt. Co., Inc.
Arenz-Warren Co.
Atlas Cornice Wks.
Atlas Mixed Mortar Co.
Atlas Roof Co.
Avalon Paint Co.
Baker-Hickman Co.
Baker Iron Works
Baker & Co., R. A.
Bank Line Lumber Co.
Barker Bros.
Bass-Hueter Paint Co.
Bawbell Lumber & Mill. Co.
Bay Lumber Co.
Bay Cities Roofing Co.
Bayer-Rothsch Co.
Benedict & Moorman
Bennett-Montgy. Hdwe. Co.
Bentley-Schoeneman Lbr. Co.
Bettingen, W. J., Lbr. Co.
Blanchard Lumber Co.
Bliss Lumber Co.
Blue Diamond Materials Co.
Bohen & Co., E. R.
Bohnhoff, C. W.
Brasch Heater Co., A. B.
Broadway Dept. Store
Brombacher Iron Works
Brown, H. W.
Bremer Marble & Tile Co.
Buhler-Sisson Lbr. Co.
Bullock's
Bungalow Fixture Co.
Burbank Lumber Co.
Burbank Planing Mill Co.
Busch Pipe & Supply Co.
Calhoun Tile & Mantel Co.
California Bank
California Door Co., The
Cal. Fireproof Door Co.
Cal. Glass & Paint Co.
Cal. Panel & Veneer Co.
Cal. Portland Cement Co.
Cal. Wall Paper Co.
Campbell & Ward
Christie & Wood
City Brick Co.
City Ornamental Iron Wks.
Clifford Co., Inc., Chas. E.
Coast Lumber Co.
Collins, G. V.
Columbia Varnish Co.
Concrete Mach. & Sup. Co.
Consolidated Lumber Co.
Continental National Bank
Contrs. Service Corp.
Contr. Machinery Co.
Consumers Rk. & Gravel Co.
Cooper Lumber Co., W. E.
Crane Co.
Crescent Sheet Metal Wks.
Crowell Co., E. W.
Crown Sash D. & M. Co.
Culver City Lumber Co.
Culver City Sash & Door Co.
Cunningham, P. C.
Davis Sash & Door Co.
Delta Mfg. Co.
Dolan-Sine Lumber Co.
Donnelly, F. J.
Dotson & Sons, P. E.
Dressler Hdware Co.
Dump Truck Smith
Dunco Metal Products Co.
Dwan, J. E.
Eagle Rock Lumber Co.
Eastman Co., Geo. L.
Economy Wall Fixture Co.
Elholm, E. H.
Esdorty, F. W.
Farmers & Merchants Nat. Bk.
Federal Water Heater Co.
Fidelity & Deposit Co. of Md.
First Mortgage Corporation
First National Bank of L. A.
Fox-Woodsum Lbr. Co.
Folghum & Company
Fuller & Co., W. P.
Ganahl Lumber Co.
Gisby & Company
Glendale Lumber Co.
Golden State Lumber Co.
Golden State P. Cement
Golding, Fred, Lumber Co.
Goodbar-Goodwin Co.
Gordon & Harrison
Graves Sash, D. & M. Co.
Green Marshall Co.
Grinnell Co. of The Pacific
Gregan-Robinson Lumber Co.
Hamburger & Sons

Hammond Lumber Co.
Harper & Reynolds Corp.
Harris & Hall, Inc.
Hartford Acc. & Indemnity Co.
Harwood's
Havens Holm Lumber Co.
Haverty Co., Thos.
Hayward Lbr. & Inv. Co.
Hellman Com'l Tr. & Sav. Bk.
Hepburn Mill Co.
Herzog Sash & Door Co.
Hill Marble Works
Hill Chemical Co., C. W.
Hipolito Screen & Sash Co.
Hokom, J., Plbg. & Htg. Co.
Hollywood Planing Mill Co.
Huff, Geo. M., Lumber Co.
Langlon Door & Sash Co.

BUILDING MATERIAL DEALERS CREDIT ASSOCIATION LOS ANGELES, CAL.
Magnum Opus Magnum Bonum

A Mutual Organization Owned and Operated by its Membership

818 SOUTH HILL STREET
SUITE 408
TELEPHONE PICO 6831

LOS ANGELES, CAL.

Langtree Hardwood Lumber Co.
Lee & Co., W. J.
Littlewaller & Gough
Llewellyn Iron Works
L. A. Art Glass Co.
L. A. Brick Co.
L. A. Lime Co.
L. A. Mantel & Tile Co.
L. A. Planing Mill Co.
L. A. Pressed Brick Co.
L. A. Rock & Gravel Co.
L. A. Screen Co.
L. A. Wall Pa. & Pt. Co.
Lounsberry & Harris
Lumber Products Sales Co.
Lynde, W. L.
Mathews Paint Co.
McGrew Paint Mfg. Co.

Meyberg Co., The
Miller Box Mfg. Co.
Monarch Screen Mfg. Co.
Montgomery Lumber Co.
Morgan Co., The
Morris, Geo. L.
Mox Lumber & Wrecking Co.
Mullin Lumber Co.
Musto Sons Keenan Co.
Natl. Paint & Var. Co.
National Hardwood Co.
Nelson Mfg. Co., H. G.
Nies, Wm.
Oakley Paint Mfg. Co.
O'Brien, Fredk. Varnish Co.
Ocean Acc. & Gte. Corp.
Olson Lumber Co.
Oro Grande Lime & Stn. Co.
Owen Roofing Co.
Owens-Parks Lumber Co.
Pacific Clay Products Co.
Pacific Coast Steel Co.
Pacific Door & Sash Co.
Pacific Lighting Fixture Co.
Pacific Manufacturing Co.
Pacific Manufacturing Co.
Pacific Pipe & Supply Co.
Pacific Plg. Mill & Mfg. Co.
Pacific Plaster Co.
Pacific-Southwest Tr. & Sav. Bk.
Pacific States Lumber Co.
Patten & Davies Lumber Co.
Peterson, A. G. &
Phillips Htg., V. & Mfg. Co.
Pioneer Boiler & Mch. Wks.
Pioneer Paper Co.
Pioneer Wtrprf. & Roof Co.
Pittsburgh Plate Glass Co.
Potter Radiator Corp.
Pursell Cabinet Co.
Reed & Son, W. W.
Reid-Gallaher Co.
Reid-Platt-Spear, Inc.
Remolite Paint Co.
Riverside Portland Cement Co.
Ross Tile Co., L. A.
Sappington, F. P.
San Pedro Lumber Co.
Sarlow Paint & Varnish Co.
Sawtelle Lumber Co.
Scriver & Quinn
Security Housing Corp.
Security Tr. & Sav. Bank
Sherman Lumber Co.
Sherwin-Williams Paint Co.
Shipe-Holtz-Lyon Co.
Shull, J. & W. C.
Sillers Varnish Co.
Simons Brick Co.
Slater Roofing Co.
Slauson Ave. Lumber Co.
Smith Bros. Mot. Truck Co.
Smith Lumber Co., Wm.
So. Cal. Hdwd. & Mfg. Co.
So. Calif. Trading Co.
So. Wn. Portland Cement Co.
Southwestern Lumber Co.
Sta. Mon. Bldrs. Sup. Co.
Sta. Monica Brick Co.
Standard Brick Co.
Standard Roof Co.
Stuart-O'Byrne Hdwe. Co.
Summerville, Chas. H.
Sunset Paint Co.
Sunset Planing Mill Co.
Sunset Tile Co.
Sutton, G. C.
Talbot-Aitken P. & W. Pa. Co.
Tate Lumber Co.
Theriot, Fred J.
Thompson, O. E.
T-O Manufacturing Co.
Treasler Orna. Iron Wks.
Tropico Potteries, Inc.
Truscon Steel Co.
Turner Co., G. H.
Tyre Bros. Glass Co.
Uhl Brothers
Ulrich Co., C. E.
Union Iron Works
Union Lime Co.
Union Rock Co.
Vernon Lumber Co.
Viney Milliken Lbr. Co.
Vineyard Lbr. & Inv. Co.
Wagner-Woodruff Co.
Warren & Bailey Co.
Waterhouse-Wilcox Pen. Co.
Weaver Roof Co.
Welch Paint & Glass Co.
Western Brick Co.
Western Hardwood Lbr. Co.
Western Planing Mill Co.
Western Sash & Door Co.
Wheeler Lumber Co.
Whiting-Mead Com'l Co.
Whittier Lumber Co.
Wilkinson Co., G. G.
Willard & Woodhull
Wilson Corp., J. G.
Wiseman Co., Geo. W.
Woodhead Lumber Co.
Wood Lumber Co., E. K.
Woods-Bochman Lbr. Co.

LETTER ENCLOSING

COLLECTION DRAFT FOR OVERDUE ACCOUNT

The enclosed COLLECTION DRAFT is mailed to you by BUILDING MATERIAL DEALERS CREDIT ASSOCIATION, a mutual organization of over two hundred and fifty building material dealers of Los Angeles. This Association is owned and operated by its members without profit for credit protection.

Unless the enclosed draft is honored or satisfactory arrangements are made for settlement of the account within ten days of its date, the facts will be recorded and your credit with the entire membership of the Association will be affected accordingly.

Inasmuch as this draft is not sent until after the Member Company signing same has been unable to collect the account upon direct demand, it is presumed that the charge is correct and unquestioned.

Remember that your credit
is your most valuable asset
in business.

Figure 14. A Method of Collection

whether the account is a new one. A recommendation is then furnished which applies to this specific order only, not to any future transaction.

The recommendations of the credit clearing house are furnished from credit centers. They are the results of an analysis of information secured by a search of the entire nation. The information is of various kinds and is secured from various sources. The ledger interchange information gives the highest credit granted to a customer, and records the customer's paying habits. An investigation of the volume of orders tells whether the customer is buying within the limit or is overbuying. Information giving the relation between assets and liabilities is secured direct from the subject. Reports of special investigators, adjusters, attorneys, and banks, note the merchant's history, his ability and local reputation, the location of his place of business, the stock which he carries and his turnover, court actions in which he has been concerned, and his banking habits. In fact, every element is included which would have any bearing upon the credit risk of the customer about whom the inquiry is made.

This information all flows into a central point where it is put into one file or folder, together with an actual record of all the dealings of the customer with the membership of the Credit Clearing House, and from the information comes a recommendation. Reasons for recommendations are not given. The patron is kept informed concerning any change in the subject's condition. A shipment may be recommended and later an unfavorable recommendation may be issued. As soon as the form of recommendation is changed, a notice is sent to all patrons who have previously inquired concerning this subject.

The system is the outgrowth of experience with both ratings and ledger interchange, the Credit Clearing House having pioneered in ledger interchange work. Fixed ratings once

printed cannot be changed, and to make a ledger interchange report as complete as it should be, takes some time. The system used by the Credit Clearing House with its continuous gathering of credit information, and the steady flow of credit facts which come to credit centers through the mechanical operation of the system, enable the Credit Clearing House to give recommendations from conditions which exist at the time inquiry is made.

The system is the result of 40 years' experience in the credit field. The recommendations are made by experts and based on the findings of 40 years' experience and study of the causes of success and failure in business. The strength of business is measured in the same careful way as is the steel, wood, or stone by an engineer or the effect of different elements by a chemist. Through its ability to accumulate and secure up-to-the-minute complete information, its efficiency in gauging the condition of a business with stated or learned facts before it, and the policy of making each transaction subject to a separate and distinct recommendation, the system has attracted much attention in the credit world.

The Credit Clearing House makes contracts with each subscriber entitling him to a certain number of inquiries—the minimum number being 100 per year. The national center is at New York City. It has its registered emblem, which many of its members print on their stationery and bill-heads.

In addition to its credit checking service, the Credit Clearing House conducts a collection department which is perhaps the only nationally standardized collection service. This collection service is unique in that it accepts no fees either directly or indirectly from bankrupt or insolvent estates and will not act in the capacity of trustee or receiver. Its rates are graduated, and it leads all other collecting mediums in volume of business and number of clients. Over 50,000 credit men use it.

The first step in the collection of an account is to send to

the debtor a multigraphed form notifying him that the clearing house patron intends to place the account with the clearing house for collection if it is not paid. If this "demand letter" result in payment within ten days, there is no collection charge to the patron.

Sometimes the "demand letter" is not used, and the patron requests immediate collection proceedings. In this case, the first step is also by correspondence, called the "special service." If neither the "demand letter" nor the "special service" result in payment, the account is placed in the hands of an adjuster or an attorney for an immediate personal demand on the debtor, or for suit.

References

Ettinger, Richard P., and Golieb, David E. Credits and Collections, Chap. VIII.
McAdow, Finley H. Mercantile Credits, Chap. VI.
National Association of Credit Men. Credit Monthly.
Prendergast, William A. Credit and Its Uses, Chap. XII.
Walter, Frederick W., Ed., The Retail Charge Account, Appendix.

CHAPTER X

COOPERATION AMONG CREDIT MEN

Tendencies toward Cooperation.—With the increasing importance of the credit transaction in the development of commerce, there has arisen greater understanding of the need for, and mutual benefits received from, credit cooperation through the confidential interchange of ledger information and experiences. Even now some credit men do not take kindly to the belief of successful ledger interchange. Some of them, while realizing the necessity of harmonious cooperation, maintain that no set standards of business can be expected because of the innumerable human jealousies arising in business transactions and that there never will be a successful and efficient interchange of information between credit men. Certainly, if such pessimism were allowed greatly to influence the present movement toward cooperation the prediction would be a true one. It is fortunate, however, that an increasing number of credit men are seeing the benefits of such mutual credit interchange and are joining the ranks of those who believe successful organization among credit men to be entirely possible.

The conception of the idea of organization of credit men for the mutual exchange of credit information may be accredited to those men attending the Commerce Congress at the World's Fair in Chicago in 1893. Here questions were raised as to the possibility of raising the standard of credit, of reducing its dangers and losses, of improving the quality of information, and of the possibility of establishing standards of requirements for granting credit. Out of this discussion there was

organized, in 1896, the National Association of Credit Men, with some 600 members at the beginning.

The idea of national interchange of credit information has been of slow growth and its mutual benefits are still matters of dispute among certain types of people, but the fundamental soundness of the idea has been tested and proved until today the National Association boasts a membership of approximately 30,000 credit men.

Based upon the ideas that have proved so sound in the National Association, local associations have been formed in the larger trade areas, state associations have arisen to assist in exchange of experience between local associations, and trades have formed trade associations—all for the one purpose of pooling credit facts for the common welfare.

The Telephone and Personal Conversation.—It speaks well for the growth of the spirit of cooperation that, although the idea began as a national issue, it has become an increasingly important local issue and has been the means of securing a spirit of mutual confidence almost amounting to comradeship between credit men of rival houses. The day is past when credit men in competitive businesses "pass by" on the other side of the street. They are more often arm in arm as they give and receive information on particular debtors to whom they are both selling. It is a significant indication of the growing regard for social welfare when the business integrity of a community demands that two individuals ordinarily representing competitive businesses must exchange information for the sake of the common welfare of the business community. It is recognized that such cooperation renders each party safe in business transactions which previously were often dangerous. Thus, by personal conversation, or perhaps by telephone, the credit man of today is accustomed to cooperate with other credit men in a definite fashion which helps business.

Luncheon Meetings.—The close cooperation of credit men is evidenced by the luncheon meetings in particular lines and trades where the credit men meet regularly to exchange credit information on a systematic basis. For instance, the credit managers of the leading hardware concerns generally find themselves at a luncheon table one day a week for the purpose of exchanging information and impressions concerning the trade. Particular cases are discussed and seldom is there a violation of confidence.

Problems peculiar to a certain line of business are more easily solved at these conferences, and this plan of separating industries into divisions enables them to seek finer adjustments. Trade meetings, then, divide the real work of cooperation into particular fields, placing the responsibility for success where it justly belongs. The more complex problems are given a hearing before the local association.

Local Associations.—Particular trade areas find that much can be accomplished by organizations which include the credit men of the various business organizations extending credit. Thus we have the development of the local association. Officers and directors are elected from among the members. They direct the credit policies of a community, tend to eliminate trade abuses of various kinds, foster cooperation favorable to particular types of legislation intended to strengthen the economic fabric of the community, and provide a means by which credit men become acquainted with each other and are enabled, through personal conversation, to gather information vital to certain accounts through channels which otherwise would be closed to them.

These local associations are organized, in general, to serve as agents for individual members and in so serving to investigate, obtain, compile and on request furnish to the inquiring member information concerning the character, reputation, gen-

eral standing, financial responsibility and paying habits of the individual or company in question. Such local associations are generally responsible for the success of ledger interchange bureaus, the creation and operation of adjustment bureaus, the functioning of a local board of trade, and the administration of bankrupt estates for the benefit of the creditors as inexpensively as possible.

They also offer cooperation with other cities in the same state, holding annual conventions of credit men where all topics of interest in this aspect of business are discussed in an authoritative manner both by members and outside speakers.

Organization of the National Association of Credit Men.—The National Association of Credit Men was organized in 1896. It sought to bring together credit grantors on a national scale in order that credit might be systematically checked and a maximum of credit business attained at a minimum of bad debt loss. In the early days of the Association, the home office was little more than a recording office and the principal duties of the secretary were to keep the records and attend to necessary correspondence. The remarkable growth of the organization has caused new departments to be added from time to time until at present a force of forty-four is employed at the national office.

The Association has a staff of representatives at Washington and the Central Interchange Bureau at St. Louis with twenty-five employees. The representatives of the Association are increasing from year to year, as it takes a great amount of the secretary's time making official visits to the one hundred odd local associations extending from coast to coast.

The officers of the Association are a president, first vice-president, second vice-president, secretary-treasurer, and executive manager. Provision is made also for a Board of Directors of twenty-four members until the Association has reached

40,000 membership, when an additional director will be added by every five thousand increase in membership. All officers, save the secretary-treasurer, who is also the executive manager, serve without pay. The work of the Association is under the direction of this Board of Directors, of which the officers are members, these men representing the larger business institutions of the country. Through national district conventions the various activities are given momentum and the opportunity is furnished for discussion of particular problems. The active head of the organization is the secretary-treasurer.

Membership in the Association may be secured by every commercial credit grantor whose standing is above question. Among the members are manufacturers, wholesalers, jobbers and bankers. Each concern is represented in the activities of the Association by the official in charge of its credits and collection work. Active campaigns are carried on to secure new memberships and prevent resignations, with the result that the Association has grown from its initial 600 members to approximately 30,000 at the present time.

Objects of the National Association.—The National Association has stated its purpose in Article 2 of the Constitution as follows:

> The object of the organization shall be the organization of individual credit men and associations of credit men to make more uniform the basis upon which credit rests; to demand a change of laws unfavorable to honest debtors and the enactment of laws beneficial to commerce in the several states; to improve methods of diffusing information and of gathering data with respect to credits; to improve business customs; and to provide a fund for the protection of members against injustice and fraud.

The scope of the work of the National Association is evidenced by the activities of its various standing committees.

There are committees on Membership, Legislation, Business Literature, Mercantile Agency Service, Credit Department Methods, Credit Cooperation, Adjustment Bureau, Investigation and Prosecution, Fire Insurance, Bankruptcy Law, Federal Incorporation Laws and Commercial Arbitration.

Campaigns of Education.—Each of these committees has been active in accomplishing the work which it was intended to do. Only a few examples may be cited here. The Bankruptcy Law Bureau has to its credit several administrative reforms. The attitude of the National Association of Credit Men may perhaps be most accurately expressed by quoting from the report of the Bankruptcy Law Committee, through the National Convention of the Association, in 1924, as follows:

> It is well, in the opinion of your Bankruptcy Law Committee, to mention at the outset of this report what should already be well known, namely—that the enactment and maintenance of a National Bankruptcy Act was one of the Association's first policies, made necessary by the unsettled condition of credits and the uncertainties of creditors' rights under the old system of state insolvency laws. Coincident with the passage of the National Bankruptcy Act was the beginning of our active commercial expansion—an expansion that may be ascribed in large measure to certain fundamental principles of the Act ensuring equality of rights and the stability of credit.
>
> Since 1898, when the Act was passed, your association has never changed its faith in the necessity of a Federal Bankruptcy Law, or its conviction that a reversion of state insolvency systems would result in turmoil and a scramble for priorities. We have considered ourselves the natural sponsors of the law. We have defended it against attacks in and out of Congress, and in two notable instances, in 1903 and 1910, we were largely instrumental in obtaining needed amendments to the law.

The Association, through this Bureau, has recently laid special emphasis upon this law throughout the country, real-

izing as it does the necessity for such uniform action in eliminating credit abuses. The Association, through this Bureau, opposes excessive costs in bankruptcy proceedings and is working for more prompt obedience to referees' orders, speedier election of trustees, earlier payments of dividends and the elimination of such other unlawful practices as have arisen.

Business men are only beginning to realize that sound fire insurance is at the very foundation of the credit system and that the tremendous annual waste of created resources by fire is burning the nation's commerce. Through the help of the National Association of Credit Men, banks and business men have been able to deal definitely with these problems. The retailer is shown the value of carrying enough sound insurance and is shown how excessive fire losses raise premium rates. The Association urges its members to adopt the plan of having their plants inspected periodically. Not only has the Association talked fire insurance, but it has gone to State Legislatures and urged fire marshal laws. The advertising matter sent out in the form of a leaflet, "Burning Subjects," has been a very effective means of presenting the subject to the public. The Committee on Fire Insurance and Fire Prevention has been instrumental in preventing many fires through fire prevention campaigns, and in emphasizing to the merchants the need of carrying adequate insurance to protect themselves and their creditors.

Service through the Adjustment Bureau of the National Association is given to debtors who are temporarily embarrassed and insolvencies are handled at cost. It is the duty of this Bureau to make investigations where losses appear imminent. Creditors are given the opportunity to take care of their own interests and to watch every detail of the expense of liquidation. By maintaining the support and loyalty of all the membership, the Bureau is able to do very effective work. "Friendly adjustments" is its slogan.

Association Publications.—The principal publication of the National Association, and the chief medium through which information of Association activities is conveyed to the members is the Association Magazine, the "Credit Monthly." This monthly carries the news of the activities of various local associations, important programs of the National Association, and articles on timely business topics in which the credit man is interested. Each member receives copies of Association leaflets and a series of sample credit department blanks suggested to encourage uniformity in recording credit information. These printed standard forms and credit inquiry blanks may be obtained from the Association at cost.

Besides the monthly literature, leaflets, and credit forms, the Association issues special literature of great interest to the credit man. These special leaflets cover such topics as:

1. The Strain Imposed by the Abuse of Sales Terms.
2. The Proper Calculation of Profits by the Retailer.
3. The Influence on Your Credit Standing of Promptness Handling Correspondence.
4. The Inventory, the Compass of a Business.

The business men of earlier days were not at all convinced that a national association of credit men would be a desirable thing. It was felt by many that credit information was of such a nature that it could not be passed from hand to hand except through private agencies. It was also felt by the mercantile agencies that such an association might develop into a reporting organization which would possibly displace them and make them less important in the present economic organization. Many retailers thought that such an association would tend to standardize credit in a way that would prevent them from buying goods on the best possible terms. The echoes of these arguments are still faintly heard, but they are gradu-

ally dying away with the multiplication of evidence to the constructive value of such an association.

References

Hagerty, James Edward. Mercantile Credit, Chap. XIV.
Hallman, J. W. Organizing the Credit Department, Chap. V.

CHAPTER XI

MISCELLANEOUS SOURCES OF INFORMATION

The Salesman.—With the development of big business and the extension of the territory served by the individual firm, the salesman becomes more and more important as a source of credit information. In many cases the salesman is the one *personal* representative of the house; he is the man who knows the customer personally, and whom the customer knows as the house representative. In cases where the credit man is unable to make personal contacts, this duty is devolving upon the salesman. It is easy to see that cooperation between the credit department and the sales department is absolutely essential to the success of a firm.

There is a diversity of opinion as to just how much satisfactory information can be secured from a salesman, but all believe that it is desirable to use the salesman more definitely in credit work.

The salesman can obtain certain kinds of information obtainable in almost no other way. He visits his customer's place of business under almost all circumstances. The general appearance of the store, bookkeeping systems, furniture and fixtures, window displays, the meeting of customers, all reflect the merchant's business ability. The salesman can tell from the stock of goods on the shelves what other firms are doing business with this merchant; what judgment the merchant shows in his buying; whether he drinks, gambles, or speculates; whether he is highly regarded in his community.

Every credit department must secure this information from some source. A salesman who enjoys the proper relations with the credit manager can often serve his house in this very

important way. As the representative of the house, if the salesman is possessed with a real interest for its success, he can gather all kinds of information concerning conditions which are a help to the credit man.

The value of the salesman's information depends to a large extent upon himself. The quality of the information furnished is in the nature of opinions and must be considered together with a knowledge of the salesman's characteristics. In many cases, in order to make a good showing on his sales, he is prone to become over-optimistic. On the other hand, there are many salesmen who have become so well acquainted with their business and their district that they are able to judge a situation as well as, or better than, the credit manager.

One of the most important assets of a business house is its "good-will." In getting and keeping the "good-will" of its customers, a house is materially aided by the cooperation of the sales and credit departments. This is well illustrated in the collection of slow accounts, when the salesman, who understands the customer's situation and difficulties and can sympathize effectively with him, can often succeed in collection and at the same time keeping the customer's good-will in cases where the credit man's letters have been of no avail.

The proper cooperation with salesmen will often eliminate the necessity of turning down accounts after they have been sold. Selecting customers is as important as turning down bad accounts; in fact, it is more important because it is constructive rather than destructive in the development of business. Sometimes salesmen go into their territory with a list indicating the good prospects in the localities to be covered.

The Salesman's Report.—The salesman generally carries a report which comes in with the order on any new account. Often, also, he fills out a slip for old accounts if there are

any changes in conditions. Two forms of salesmen's reports are shown in Figures 15 and 16.

The Attorney.—Some firms have found that attorneys may be a means of securing supplementary credit information.

What Credit Limit do you Consider Him Entitled to?.........

Mortgage...........Value............

	Store....................................
Real Estate Owned	House....................................
	Lot......................................

Equipment, Number and Kind of Autos.......................
Dough Mixer...
Oven..
Moulder...
Rounder...
Cake Machine..
Pie Machine...
Troughs...
Racks...
Store Fixtures ....
Fountain Fixtures.......................................
Number Tables...
Carbonator..
Stock...
Miscellaneous...
Estimated Net Worth.....................................

Salesman...................... Date........................

Figure 15. Salesman's Report on a Specialized Line

This applies particularly to the small town attorney, who knows the debtor and his place of business, his reputation and the local conditions affecting his standing. The attorney can get information on business ability, habits, local reputation, local conditions, value of property, outstanding claims and lawsuits,

and other personal items which the merchant in a distant city is unable to get. Home town gossip is a source of informa-

Salesman's Credit Recommendation to be Mailed with all New Accounts and used in Recommending Temporary and Permanent Increased Ratings.

Recommended Limit $......................Terms................
Name.........................Trade Style......................
Partners' Individual Names......................................
Address..........................Business.....................
Banks used...............................At......................
Age......................Married or Single....................
Character..................Ability..............Capital...........
Previous Business Experience..................................
Overhead Expense................Competition...................
Does he sell for cash?.........Does he extend credit?..............
To what extent?..................Does he use caution?...........
Local condition and prospects for success........................
Investment Stock $.................Fixtures $.................
Real Estate...
Other Assets..
Carries $...........Insurance on stock $...........on fixtures
Names of Insurance Companies.................................
Is he using borrowed capital—if so, how much? $.................
What security has he given?....................................
Reputation for paying bills.......................................
What other houses extend him credit?............................
Have you explained our terms?...................................
Other Remarks..

Date..................   ....
Salesman's Signature

For Dept. Use only
Bradstreet rating..................Dun rating...................

Figure 16. Salesman's Report on Typical Business

tion more or less reliable on all of these points. Though not wholly reliable, it sometimes gives useful warning of the need for further investigation.

Nevertheless, while the attorney has access to many sources which the average citizen is unable to reach, the reports of credit men are not very favorable to his usefulness as a source of credit information. This is due largely to the very nature of the legal profession. The merchant to be investigated may be a client of the attorney from whom information is asked. In the oath which the attorney takes upon entering the practice of law he swears to maintain inviolate the confidence and at every peril to himself, to preserve the secrets of his client. The attorney is therefore prohibited from giving any reliable information which he might possess.

As to persons other than clients, of course, the attorney would not be restricted in any way, and his value as a source of information would depend upon the size and character of his practice. But here, too, he is restricted in his ability to furnish information. The attorney is not primarily a business man. His training is cultural and technical; and so, as a rule, he is not an expert in giving advice on a credit risk. In a general way, he can furnish information valuable in determining the conditions affecting property, for he can investigate and report the clearness of the title as to heirs and encumbrances. However, this information is usually on record, and can be ascertained by any individual through a search of the public records.

Furnishing credit reports is an incidental matter to the average attorney, and he seldom furnishes the report except as a matter of convenience for his clients. An attorney of good repute, who has a worth while practice, is unable to take the time necessary for making a reliable report. Another item to be considered is that no business house would pay the attorney for a credit report at the same rate of compensation that the same firm would pay for research in other lines.

There are in most communities attorneys who specialize in commission business, and maintain a separate department

for the purpose of supplying credit information. Various publishers develop lists of attorneys who are available for this purpose. An example of this is found in the Martindale Service. This Service prints the name of a subscribing attorney from each town who has been found, after due investigation, to be of good repute. This list is published in book form and distributed to mercantile houses. The aim of the Service is to help business houses make collections in various parts of the country at the least possible expense. Oftentimes forms are prepared to fit the particular situation, both for the use of the house asking information and the use of the attorney.

The Bank.—Credit men have not been found enthusiastic about the bank as a source of direct credit information.

Banks are eager to know whether or not a borrower is maintaining a good credit reputation among mercantile houses and are always asking for complete information concerning depositors who wish to secure bank loans. That the credit manager of a mercantile establishment should cooperate with a bank is accepted as good business practice, for the bank account of any person is a good credit indicator and all business firms have been schooled for decades in the idea that any business man who declines to show himself to his banker becomes the victim of his own prejudices. If he refuses to give complete information he is open to suspicion and distrust.

On the other hand, when the credit man asks for information from his bank, he often finds it difficult to obtain. The answer given most often by a bank includes merely a statement that Mr. So-and-so keeps a good balance and he is considered to be a good customer. The justification of the banker in this connection is generally prefaced by such arguments as the following:

Banks are held responsible by public authority as fiduciary institutions.

Banks work on a smaller margin of profit than is customary in mercantile pursuits.

Merchants are more dependent on their bank than on any one creditor. Banks are responsible for their own funds and also for those left them by their depositors to whom their responsibility is rigidly outlined by law. Out of the nature of the situation then there comes an ultraconservative policy.

The bank builds up with its clients a confidential relation which bars the free exchange of direct information. There is, though, one function which the bank can perform as a source of credit information—that of verifying information already received from other places. If the customer states that he has a certain balance, the banker will ordinarily indicate whether or not it is correct. If the customer states that he has borrowed a certain amount from the bank, it can be verified. If the customer states that he always meets his bank loans promptly this fact can be verified. The bank can also give information as to whether or not a customer honors drafts passed through the bank and can confirm or deny apparent financial strength as indicated from other sources of information. The bank is interested in credit; the mercantile firms are interested in credit. Neither can afford to discourage legitimate methods of acquiring credit data. More cordial relations, more reciprocity, are needed in credit dealings between banks and credit managers. This seems to be a source of credit interchange which may well be developed.

Trade Journals and Other Publications.—Most firms now belong to trade associations. These associations often furnish credit information direct in the shape of reports and special communications and they generally have a publication which is

filled with news of the trade picked up from time to time by the editorial staff. It is quite possible for a credit man to be on the subscription list of most of the publications of trade organizations in which his customers may be interested and by keeping up to date on what he finds in them, he has available a vast supply of supplementary information bearing upon many of his customers. The trade journal and the trade journal's representatives are well acquainted with trade gossip.

Besides the trade publications there are numerous other magazines where small items concerning individuals and their successes and failures become the beckoning or warning signs respecting particular individuals, so far as the reader is concerned, if he is quick to draw conclusions and to scent implied connections. Most communities have a business paper as well as daily papers and local magazines. All of these serve as a source for items of information essential to a well-rounded knowledge of a credit subject.

Statistical and Economic Services.—In addition to this type of information, statistical and economic services of various types answer the same purpose. The credit manager is not only interested in individual success or failure but in the success or failure of particular groups in the business world. He is interested in a comparative study of expense in his particular line of business. To a certain extent he is the "watch dog of the treasury" and is at all times interested in the general economic welfare of the nation. He will consult Moody's Manual for detailed information concerning the financial standing of particular firms, as well as the regular reports of the Mercantile Agency. He will also read with care some one of the statistical services of a national character such as the reports of the Harvard Economic Service, the Brookmire Economic Service, or Babson's Reports. He cannot, if he is wise, be guided blindly by any of these which he may read, but he

can find in them a basis for his own study of conditions as he finds them applying to his particular business. As he gets successful reports, gathers comparative statistics in a particular line of business, he finds himself growing in a knowledge of the business and possessed of a number of mental measuring sticks of success or failure. All these supplementary sources of information serve to strengthen his position and he grows in the ability to command at a moment's notice an organized array of all material and in the power to draw conclusions on the basis of this array in accordance with the true condition of the subject's business.

References

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Hagerty, James Edward. Mercantile Credit, Chap. IX.

Walter, Frederick W., Ed. The Retail Charge Account, Chap. X.

CHAPTER XII

THE FINANCIAL RECORD AND ITS INTERPRETATION

The Relationship of Accounting to Credit.—The credit manager as a part of the management or at least as a representative of the management is interested in running the business with a view to a fair profit for an economic service rendered to the community. The financial success of the business is the ultimate aim. He is dealing with other firms whose ultimate aim is also financial success. In an economic organization, such as the one in which we live, financial success or failure is measured in monetary terms—in dollars. Dollars are merely the units of a system of measure by means of which we give numeric expression to the relationship between goods and a standard of value and medium of exchange, or as we commonly term it, money. To indicate whether or not at the end of a period of operations we have improved our financial position, a system for the recording of all commercial transactions must necessarily be adopted. The record, by means of which we indicate income and out-go and make a statement of our financial standing, is called book-keeping. If all transactions were cash transactions, less accounting would be necessary because the amount of money on hand at the end of a period would indicate the proportion of success which had been attained. The credit transactions, however, call for detailed records in order that no aspect of any particular transaction may be forgotten during the period of time between the first and second transfers of property. In the accounts, then, the credit manager finds one of his chief sources of information and his record of the paying habits of his customers, together

with complete statements of their actual standing at a particular time. This development has often led, as suggested in an earlier chapter, to the natural evolution of the bookkeeper into a credit manager.

Sources of Financial Information.—The primary source of financial information is, of course, the books of the customer. His record of expenses and income and the financial statement which he takes off at periodic intervals furnish the original data for the financial record presented to the credit man as a basis for the granting of credit. The financial statement is a summary of condition at a particular time indicating what is owned and what is owed. In it are reflected the results of the business transactions carried on during a period of time. The profit and loss statement or income and expense account indicate the manner in which the existent condition was created. It has been effectively said that a financial statement is a photograph of the business as it stands, while a profit and loss account is a moving picture of the financial operations of the business during a given period of time.

Secondary sources for financial information include banks, mercantile agencies, and other customers. These serve as a check against that information which comes directly from the original books of account.

Business Practice in Relation to Financial Statements.—The question of demanding financial statements is one which must be settled in each individual case in the light of particular circumstances. In some lines of business it is customary for debtors to furnish complete statements at regular intervals to all the firms from which they buy. It can be said that the number of debtors who regard the request for a copy of a financial statement as being too prying is gradually growing less.

Most business men are coming to believe that the giver of credit is a contributor of capital and becomes in a certain sense a partner of the debtor; as such he has a perfect right to complete information of the condition of the debtor. It is becoming more generally recognized, also, that no credit managers will willingly refuse credit to a customer if there is any justifiable proportion between the credit asked and the basis of credit upon which such a request is predicated.

It has been indicated that statements come in two ways, directly and indirectly. Many houses still believe that the report of the mercantile agency is sufficient and many firms asking credit will often refer such a request for a direct statement to the mercantile agency for an answer. If all honest successful debtors could be convinced that direct statements are effective instruments, tending to eliminate fraud, then they would accede more cheerfully to requests for such statements. Such financial statements are not evidence of weakness but rather enhance the faith which is already a part of the credit relation.

Forms of Financial Statements.—There are almost as many forms of financial statements as there are individual accountants and auditors who prepare them, but in recent years there has been a pronounced tendency to standardize reports of financial standing both in trade associations and among the public generally. Certified public accountants, committees representing bankers' associations, and credit and trade associations have worked together for the standardization of these financial reports so that time may be saved in their analysis and the purpose for which they have been created may be achieved.

The National Association of Credit Men has adopted standard forms which it provides for its members, attempting to take advantage of all of the desirable points in the prepara-

tion of such statements. One of the simpler forms is presented in Figure 17.

Other good statement forms are those used by Federal Reserve Banks shown in Figures 18–20. They are intended merely as guides and are not presumed to be sufficiently comprehensive to cover all concerns.

More complete statement forms—adopted and recommended by the National Association of Credit Men are shown in Figures 21 and 22.

Form of Profit and Loss Statement.—It is sometimes important to obtain more intimate information concerning the progress of a business than is revealed by a financial statement. To know the actual profits and expenses of a business is to know more of its credit capacity. It can be seen by examination of the following simple form that much valuable information is made available. Its actual interpretation is taken up in another paragraph.

CARSON AND THOMAS

INCOME AND EXPENSE FOR MARCH, 1924

Sales of Mdse.		$8,000.00
Mdse. Inventory, March 1	$25,000.00	
Mdse. Purchases	4,500.00	
	29,500.00	
Mdse. Inventory, March 31	24,000.00	
Cost of Mdse. Sold		5,500.00
Gross Profit on Sales		2,500.00
Expenses:		
Sales	700.00	
Administrative	525.00	
Financial	25.00	
Total Expenses		1,250.00
Net Profit		$1,250.00

PROPERTY STATEMENT OF ....

TO .... ← {This space for name of party asking for statement

[FORM ADOPTED AND RECOMMENDED BY THE NATIONAL ASSOCIATION OF CREDIT MEN]

For the purpose of obtaining merchandise from you on credit, we make the following statement in writing, intending that you should rely thereon respecting our financial condition as of (Date)..............................192.....

(ALL QUESTIONS SHOULD BE ANSWERED. WHEN NO FIGURES ARE INSERTED, WRITE WORD "NONE")

ASSETS	DOLLARS	CENTS	LIABILITIES	DOLLARS	CENTS
			OWING FOR MERCHANDISE		
Merchandise, Cost or Market Value..........			On Open Account, Notes or Acceptances not due..........		
Accounts and Notes Collectible..........			On Open Account, Notes or Acceptances past due..........		
			OWING FOR BORROWED MONEY		
Cash on Hand..........			To Bank..........		
Cash in Bank..........			To Friends, Relatives and Others..........		
Machinery, Fixtures and Equipment (Present Value)..........			**Total Business Liabilities**..........		
Total Business Assets..........			Liens or Chattel Mortgages on Merchandise, Stock and Equipment		
Real Estate..........			Mortgages on Real Estate..........		
Other Assets..........			Other Liabilities..........		
....			....		
			....		
Total Assets			**Total Liabilities**		

Annual Sales for Cash	$..........	Insurance on Merchandise and Equipment	$..........
Annual Sales on Credit	$..........	Insurance on Real Estate	$..........
Total Annual Sales	$..........	Life Insurance for benefit of the Company	$..........
Total Annual Expenses	$..........	Is any Insurance assigned?..........	

Title to Real Estate is in name of..........

Location and kind of business?.......... How long there?..........

Do you keep books of account?..........

When did you take last inventory?.......... Did you take inventory at cost or market price?..........

Do you hold any **merchandise** on consignment or conditional sale?.......... If so, what amount? $..........

Is any **machinery** or **equipment** held on conditional sale or lease?.......... Amount to be paid thereon $..........

If any creditors are secured by Lien or Chattel Mortgage, state amounts and how secured..........

Name and Address of your Bank?..........

Buy principally from the following concerns:

Name	Address	Amount	
....	....	....	.....
....	....	....	.....
....	....	....	.....
....	....	....	.....

Firm composed of, (or if Corporation—Officers' Names)..........

....

Address.......... Town.......... State..........

Dated at.......... this.......... day of.......... 192.......

(Name of Firm or Corporation)..........

Witness.......... Signed by..........

Figure 17. Statement Form Adopted by the National Association of Credit Men

FARMER.

Statement of.................................Address.......................................

TO..

I make the following statement of all my assets and liabilities as at the close of business on.............

ASSETS				LIABILITIES			
Cash on hand and in bank........				Accounts and notes owed by me without security..............			
Loans and accounts due to me (good)				Notes or mortgages owed by me with real estate as security.....			
Farm Products..................				Notes owed by me with chattel mortgage as security..........			
Live Stock.....................				Other indebtedness (itemized)			
Total convertible assets.......				....			
Farm land and buildings (see schedule)				....			
Farm implements and machinery...				....			
Other property (itemized)				....			
....				TOTAL LIABILITIES..........			
....				Net worth....................			
....							
TOTAL.....................				TOTAL....................			

Location of Land Owned	Acres	Estimated Value	Assessed at	Mortgaged for
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....

Title.—The title to all above described real estate is in my name solely, except as follows:.............:
....
....

BUILDINGS.—State general character..............
....
IMPLEMENTS.—State general character of those listed as assets.....................................
....
....
....
INSURANCE.—Fire $.............Life $...........
Who is beneficiary?...........................
....
....

CONTINGENT LIABILITY as indorser or guarantor..................... $.........
ACCOUNTS AND NOTES PAYABLE. (If any are past due state amounts and reasons)...............................
....
....
OTHER LIENS.—(If any other liens on assets, state amount and circumstances).........
....
....

I hereby certify that the figures and statements contained on both sides of this sheet are true and give a correct showing of my financial condition.

Signed this.............day of.......................19....

(See reverse side) Name.......................................

Figure 18a. Form used by Federal Reserve Banks—Farmers (face)

State character of loans and accounts listed as assets..

....

....

....

....

If any leased land used, state acreage, nature, use and terms of rental..............................

....

....

....

....

(The balance of this space may be used for writing any questions desired to be asked amplifying statement of condition as shown on reverse side.)

Figure 18b. Form used by Federal Reserve Banks—Farmers (back)

If in addition it is possible to obtain a detailed account of the items of expense classified under such headings as salaries, heat, light, rent, advertising, taxes, insurance, bad debts, officers' salaries, etc., it is still easier to diagnose the financial health of the concern.

Importance of Interpretation.—When the statement is received the work is only begun, as a financial statement is nothing more than the condensed record of the books. A well kept set of books and a report set up in standard form may not mean much to the man who does not understand them; the facts must be interpreted so as to tell the complete story of the business. It is here that the analytical ability of the credit manager is brought into play. The credit man, possessed of an imagination sufficient to build up a complete set of relationships from the figures presented to him in a financial statement, is indeed fortunate. To him figures become indications of tendencies and trends in the success or failure of the

FIRM

Rating { Bradstreet / Dun

To..

Statement of..

Business .... Address..

Condition shown by........................books and inventory of ....19........

ASSETS	
Cash on hand and in Bank	
Notes Receivable of Customers:	
Current	
Past Due, Cash Value	
Accounts Receivable of Customers:	
Current	
Past Due, Less than 6 months	
Past Due, over 6 months	
Acceptances of Customers	
Merchandise:	
Finished	
In Process, Unfinished	
Raw Material	
United States Government Obligations	
Collateral Pledged to Loans:	
Notes Receivable	
Accounts Receivable	
Trade Acceptances	
Merchandise	
Securities	
Other Active Assets	
Total Current Assets	
Due from Controlled or Allied Concerns: For Merchandise	
For Advances	
Stocks, Bonds and Investments	
Land	
Buildings	
Machinery, Equipment and Fixtures	
Horses, Wagons and Automobiles	
Good Will, Patents and Trade Marks	
Other Assets—Itemize	
Deferred Assets	
TOTAL	

LIABILITIES	
Notes Payable for Merchandise	
Acceptances Issued	
Notes Payable to Banks	
Notes Payable for Paper Sold	
Notes Payable to Others	
Accounts Payable—Not Due	
Accounts Payable—Past Due	
Secured Liabilities by	
Notes Receivable	
Accounts Receivable	
Trade Acceptances	
Merchandise	
Securities	
Any Other Current Liabilities	
Total Current Liabilities	
Mortgages or Liens on Real Estate	
Bonded Debt	
Chattel Mortgages	
Any Other Liabilities—Itemize	
Reserve—Itemize	
Net Worth	
TOTAL	

(See Reverse Side)

Figure 19a. Form used by Federal Reserve Banks—Firms (face)

Insurance

On Merchandise?.................. On Plant?.................. Credit?.................. Liability?..................

Contingent Liability of Any Kind

Upon Receivables Discounted or Pledged				
Upon Accommodation Paper or Endorsements				
Customers' Accounts Sold and Assigned				
As Guarantee for Others on Notes, Contracts, etc				
For Bonds or Unfinished Contracts				
For Leases				
Other Contingent Liabilities				

Condensed Profit and Loss Statement for Fiscal Year Ending..................192

EXPENSE				INCOME			
Cost of Material or Merchandise consumed				Net Sales			
Actual Expense of Conducting Business, including Rent, Taxes, Insurance, etc				From Investments			
				From Discount in Purchase			
				From Other Sources—Itemize			
Int. on Borrowed Money, Bonds							
Bad Debts Charged Off							
Depreciation Charged Off							
Net Profits							
Total				Total			

I—we have audited the accounts of.................. for the period from..................

to.................. and certify that in my our opinion the above Balance Sheet and Statement of Profit and Loss set forth the financial conditions of the firm or company at.................. and the results of its operations for the period.

....
Public Accountants.

Name..................

By..................

WORTH OF ENDORSERS EXCLUSIVE OF THEIR INTERESTS IN THE BUSINESS

.... $.................. .... $..................

.... $.................. .... $..................

.... $.................. .... $..................

Figure 19b. Form used by Federal Reserve Banks—Firms (back)

Form No. 676-5m-4-23-J

CORPORATION

Rating { Bradstreet / Dun

To______________________________

Statement of____

Business________________________Address____________________

Condition shown by________books and inventory of____________________19____

Corporate Name
Main Office
Branches
Location of Plant

ASSETS		LIABILITIES	
Cash on hand and in Bank		Notes Payable for Merchandise	
Notes Receivable of Customers:		Acceptances Issued	
Current		Notes Payable to Banks	
Past Due, Cash Value		Notes Payable for Paper Sold	
Accounts Receivable of Customers:			
Current		Notes Payable to Officers, Directors and Stockholders	
Past Due, Less than 6 months			
Past Due, over 6 months		Notes Payable to Others	
Acceptances of Customers		Accounts Payable—Not Due	
Merchandise: Finished		Accounts Payable—Past Due	
In Process, Unfinished		Accounts Payable to Officers, Directors and Stockholders	
Raw Material		Deposits of Money with this Co. by Officers and Others	
United States Government Obligations			
Collateral Pledged to Loans: Notes Receivable		Secured Liabilities by Notes Receivable	
Accounts Receivable		Accounts Receivable	
Trade Acceptances		Trade Acceptances	
Merchandise		Merchandise	
Securities		Securities	
Other Current Assets		Any Other Current Liabilities	
Total Current Assets		**Total Current Liabilities**	
Due from Controlled or Allied Concerns: For Merchandise		Mortgages or Liens on Real Estate	
For Advances		Bonded Debt	
Stocks, Bonds and Investments		Chattel Mortgages	
Land		Any Other Liabilities—Itemize	
Buildings			
Machinery, Equipment and Fixtures			
Horses, Wagons and Automobiles			
Notes Receivable—Due from Officers, Stockholders and Employees		Reserve—Itemize	
Accounts Receivable—Due from Officers, Stockholders and Employees			
Good Will, Patents and Trade Marks		Capital Stock—Com. Outstanding	
Other Assets—Itemize		Capital Stock—Pref. Outstanding	
		Surplus and Undivided Profits	
Deferred Assets			
TOTAL		TOTAL	

(See Reverse Side)

Figure 20a. Form used by Federal Reserve Banks—Corporations (face)

Insurance

On Merchandise?________On Plant?________Credit?________Liability?________

Contingent Liability of Any Kind

Upon Receivables Discounted or Pledged				
Upon Accommodation Paper or Endorsements				
Customers' Accounts Sold and Assigned				
As Guarantee for Others on Notes, Contracts, etc.				
For Bonds or Unfinished Contracts				
For Leases				
Other Contingent Liabilities				

Condensed Profit and Loss Statement for Fiscal Year Ending____________192

EXPENSE				INCOME			
Cost of Material or Merchandise consumed				Net Sales			
Actual Expense of Conducting Business, including Rent, Taxes, Insurance, etc.				From Investments			
Salaries Paid to Officers ____ $				From Discount in Purchase			
Int. on Borrowed Money, Bonds				From Other Sources—Itemize			
Bad Debts Charged Off							
Depreciation Charged Off							
Net Profits							
Total				Total			

Surplus and Undivided Profits

At Close of Previous Year $												
Less Charges Not Applicable to Current Year	$											
Add Net Profits as Above—Itemize	$				$							
Less Dividends (Preferred (Per Cent)	$											
(Common (Per Cent)	$				$							
Undivided Profits									$			

I—we have audited the accounts of__________for the period from__________ to__________and certify that in my our opinion the above Balance Sheet and Statement of Profit and Loss set forth the financial conditions of the firm or company at__________and the results of its operations for the period.

____
Public Accountants.

Name____________________

By____________________

WORTH OF ENDORSERS EXCLUSIVE OF THEIR INTERESTS IN THE BUSINESS

	$		$
	$		$
	$		$

Figure 20b. Form used by Federal Reserve Banks—Corporations (back)

PROPERTY STATEMENT

OF

____

TO

____

"Large assets are not always necessary to the creation of credit; what is most desirable is that credit be in relative proportion to the actual assets."

[illegible]

Form Adopted and Recommended by the National Association of Credit Men

For the purpose of obtaining merchandise from you on credit, we make the following statement in writing, intending that you should rely thereon respecting our financial condition as of (Date)________________ 19___

(All questions should be answered. When no figures are inserted, write word "None.")

ASSETS			LIABILITIES		
Cash in hand			For MERCHANDISE		
Cash in bank			Accounts owing not due		
Accounts owing by customers, good and collectible, not pledged or sold			Accounts owing past due		
Notes owing by customers, good and collectible, not pledged or sold			Trade Acceptances payable		
Trade Acceptances receivable, not pledged or sold			Notes payable for Mdse.		
Merchandise (not on consignment or conditional sale) (How valued, Cost___ Market___)			For BORROWED MONEY		
Other quick assets. (Describe)			Notes payable to Banks		
			Notes or debts payable to others (including relatives and friends)		
			Deposits of money with us (Describe)		
			Owing for Wages and Salaries		
			Owing for Taxes (city, state and federal)		
			Owing for Rents		
			Owing for Insurance Premiums		
TOTAL QUICK ASSETS			TOTAL QUICK LIABILITIES		
Machinery (How valued, Cost___ Depreciated___)			Debt secured by mortgage on land or buildings		
Fixtures and other Equipment (How valued, Cost___ Depreciated___)			Debt secured by chattel mortgage or other liens		
Land and Buildings as described below			Debt secured by assignment		
Notes and Accounts owing from officers, employees, or others not customers			Other liabilities. (Describe)		
Other assets. (Describe)			TOTAL LIABILITIES		
			NET WORTH: Capital Stock (Preferred, Common); Surplus and Undivided Profits		
TOTAL ASSETS			TOTAL		

What books of account do you keep? ________________

Was this statement made from these books? ________ Do you keep cost records? ________

Do you sell or pledge your accounts to creditors, banks, finance companies or others? ________ If so what amount is so sold or pledged? $________ What amount of your accounts have you sold or pledged during the past twelve months $________

Are any creditors secured by mortgage or lien of any sort? ________ If so, how? ________

Are any claims in attorneys' hands or suits against you? ________

Have you merchandise on consignment or conditional sale? ________ If so, what amount? $________

If business property is leased, for what term and what rental? ________

Name and locality of your bank or banks ________

Location and kind of business ________

Under the laws of what state is your business incorporated? ________

Previous business experience ________ Where ________

It is important that every question [illegible] be correctly answered and that the [illegible]. In answering questions involving amounts write the word "none" where figures do not apply. You will find it advantageous to keep a copy of this statement for comparison with the showing you will be able to make a year hence.

Figure 21a. Form Adopted and Recommended by the National Association of Credit Men (face)

INSURANCE

On Merchandise $______ On Buildings $______ Machinery $______ Fixtures $______

Other Equipment $______ Employers' liability $______

Is any insurance assigned?______ What amount?______ To whom?______

Amount of life insurance for benefit of business $______

With what companies______

SUMMARY OF PROFIT AND LOSS

Inventory of Mdse. beginning of fiscal year (not including fixtures or equipment)			Sales last fiscal year		
			Income from all other sources		
Cost of Mdse. purchased during the year			Inventory of Mdse. at close of year		
General expenses including salaries, losses, etc.			Total Income for year		
			Less Total Expenses		
TOTAL EXPENSES			NET PROFIT FOR YEAR		

RECORD OF LAND AND BUILDINGS

Title in name of	Description and location	Book value	Assessed value	Amount of Encumbrances	To whom

BUY PRINCIPALLY FROM THE FOLLOWING CONCERNS

Names	Addresses	Amount Owing			
		Open Account		Notes	

Names and Addresses of Officers______

REMARKS:

The foregoing statement has been carefully read (both printed and written matter) and is in all respects complete, accurate and truthful. It discloses to you the true state of our financial condition on the date above stated. Since that time there has been no material unfavorable change in our financial condition; and if any such change takes place we will give you notice. Until such notice is given, you are to regard this as a continuing statement.

Name of Corporation______

Signed by______
(Designate office held)

Street______ Town______ State______

Date of signing statement______ 19___

Form 8.

Figure 21b. Form Adopted and Recommended by the National Association of Credit Men (back)

USE LETTER OPENER HERE

USE LETTER OPENER HERE

USE LETTER OPENER HERE

WESSEL'S ENV-O-BLANK
TRADE MARK
REGISTERED IN U. S. PATENT OFFICE
AMERICAN LOOSE LEAF MFG. CO.
SOLE MFRS. CHICAGO

...old			To Others (Including relatives and friends)		
...ptances receivable			Owing for Wages and Salary		
...handise, (How valued: Cost or Market?)			Owing for Rental and Taxes, (City, State, Federal)		
TOTAL QUICK ASSETS			Owing on Land and Buildings		
			TOTAL QUICK LIABILITIES		
Machinery, Fixtures and Equipment					
Land and Buildings as described on reverse side					
Owing from officers or members of firm, employees and others not customers			Debts secured by mortgage on real property, chattel or other liens		
Other assets			Other Liabilities		
			TOTAL LIABILITIES		
			NET WORTH		
TOTAL ASSETS			TOTAL		

Insurance
On Merchandise $______ On Buildings $______
On Machinery, Furniture and Equipment $______ For Employers' Liability $______
Amount of Life Insurance for benefit of business______
Is any Insurance assigned? $______ If so, to whom?______

Do you pledge or sell accounts or notes owed you by customers to banks or finance companies or others?______ If so, what amount is pledged?______

Are any of your creditors secured by mortgage or other lien?______ If so, how?______ Amount $______ Who?______

Are any claims in attorneys' hands or suits against you?______

Average Monthly Sales $______ Portion in Cash______ Portion on Credit______ Average Monthly Expense $______

Do you keep books of account?______ If so, what books of account do you keep?______

Are the above figures estimated or taken from books of account and inventory?______

When did you take last inventory?______ At cost or market?______

Is any portion of merchandise shown in above assets on consignment or conditional sale?______ If so, give details______

Amount and nature of any contingent liability by endorsement or guarantee for others______

If your business property is leased, for what terms and rental?______

Give exact location of business and how long established there______

Previous business experience and where______

Name and locality of your bank or banks______

Please answer all questions. Where no figures are inserted, write word NONE.

The foregoing statement has been carefully read (both the printed and written matter,) and is in all respects complete, accurate and truthful. It discloses to you the true state of my (our) financial condition on the______day of______19____. Since that time there has been no material unfavorable change in my (our) financial condition; and if any such change takes place I (we) will give you notice Until such notice is given, you are to regard this as a continuing statement.

Name of Individual, Firm or Corporation______

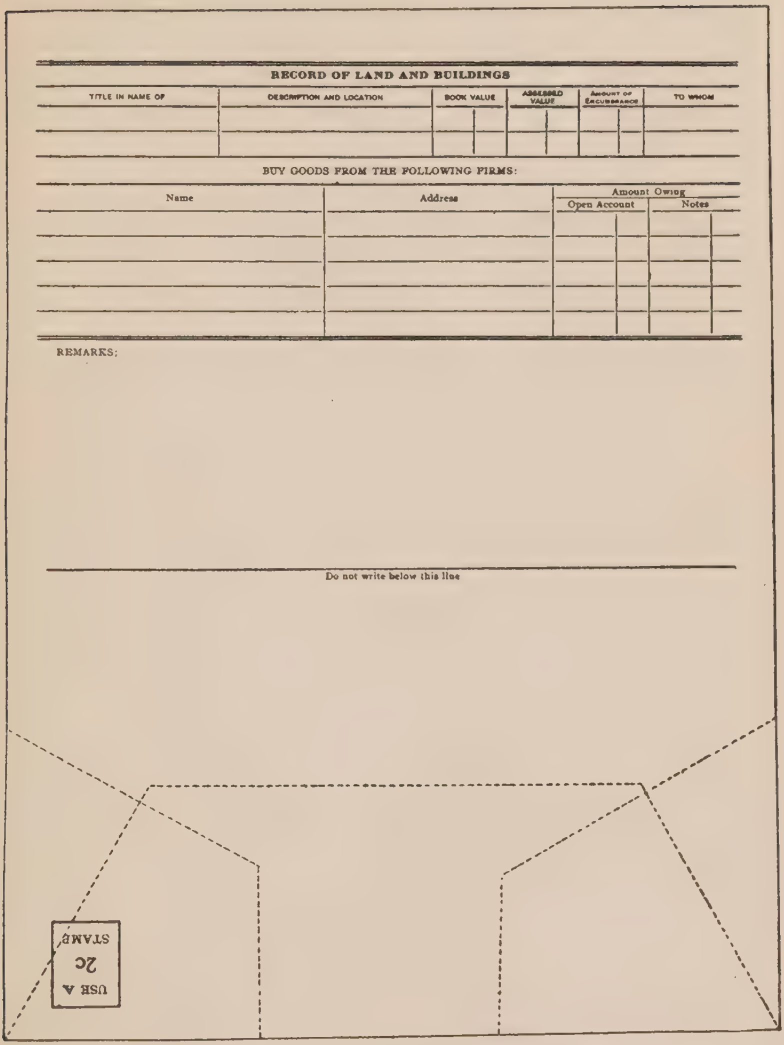
Signed by______

Date of Signing Statement______ Street______ Town______ State______

IF PARTNERSHIP NAME PARTNERS. IF CORPORATION NAMES OF OFFICERS.

Be sure to give a Complete List of Houses You Deal With and Amount Owing Each on reverse side of this sheet, also record of land and buildings
(OVER)

Figure 22a. Property Statement—Envelope Form (face)



RECORD OF LAND AND BUILDINGS

TITLE IN NAME OF	DESCRIPTION AND LOCATION	BOOK VALUE	ASSESSED VALUE	AMOUNT OF ENCUMBRANCE	TO WHOM

BUY GOODS FROM THE FOLLOWING FIRMS:

Name	Address	Amount Owing	
		Open Account	Notes

REMARKS:

Do not write below this line

USE A 2c STAMP

Figure 22b. Property Statement—Envelope Form (back)

particular business and those relationships suggest questions to him by means of which he soon knows the business of his customer as if it were his own. He is thus put in a position, not only to protect the house, but also through just and tactful suggestion to aid his customer in the financial administration of the customer's business.

To form correct conclusions, it is essential that the assets and liabilities be stated in such a way as to place beyond doubt the nature of the items included. It is also necessary to have a clear understanding of the meaning of the varied items commonly included. For the purpose of this explanation, we shall assume that a statement is before us filled out on the standard form approved by the National Association of Credit Men (Figure 17).

Assets: The term "ASSETS" refers to property owned, not necessarily free from debt, but including all items the possession of which is presumed to lead to the creation of profits or the enjoyment of property rights. In the United States these are generally listed at the left hand side with the liabilities opposite. Assets may be roughly classified as being of two types: "quick" and "other assets." By quick assets or current assets are meant those which include cash or items which can be readily transformed into cash, such as accounts receivable, notes receivable, merchandise or government bonds. Among "other assets" would be included machinery, fixtures, land, buildings, of just as definite a value, but of such a nature that ready transformation into cash is impossible.

Cash in hand refers to money in the drawer and safe. Sometimes it does include items which are in reality not cash, as for instance, I. O. U.'s, memoranda covering withdrawals, paid cash bills and expense vouchers. If unduly large, it means either carelessness in the handling of money or the inclusion of items which are not properly included in cash.

Cash in bank can be checked to some extent. It is, however, subject to withdrawals at any time. If unusually large it would indicate a disregard for an opportunity to turn it into some short term security that would give the business greater returns than the normal interest on a bank account affords. The credit manager should be confident that there are no liens or offsets against this account.

Accounts Receivable properly refers to accounts owing by customers and should include only those good and collectible, not pledged or sold. From the credit manager's point of view accounts receivable furnish the avenue by which merchandise is transferred into cash. A healthy condition of business is more dependent upon the condition of accounts receivable than upon the condition of merchandise. It has been said that merchandise measures the merchant's ability to sell, but accounts receivable measures his ability to sell wisely.

Overdue trade accounts are present in a greater or lesser degree in nearly all businesses. It is not always easy to determine their value. However, it must not be forgotten that such accounts are often good even though slow, and if the terms of credit have been habitually ignored it may be wise to put emphasis upon more prompt payment. If payments on account are being made, but so slowly that the balance is increased rather than decreased, there is prima facie evidence of weakness. If credit has been stopped and no recent collections appear, it is important that disposition of the account be arranged on a basis which will close it in the shortest possible time. The credit manager gives particular attention to the debtor who has paid cash but who commences to give notes. These, and other considerations, help to determine the value of overdue trade accounts.

Accounts receivable sometimes contain what are called fictitious accounts receivable. These include advances to sales-

men and others, overdrafts of officers, claims against railroads or against the government and advances on purchase contracts. Sometimes accounts receivable carry deferred charges to operations such as prepaid rent and in some cases intercompany transactions have not been shown separately. In other cases accounts receiveable have included stock subscriptions. All these items, if included in accounts receivable, are fictitious. Accounts receivable refer properly to money due for merchandise sold in the regular course of business.

Another question which must always be asked is whether or not a reserve for doubtful accounts has been set up. This account anticipates bad debt losses and creates a reserve which acts as a "cushion" to absorb the shock of losses.

Pledged or discounted receivables often raise a question. A contingent liability should be set up to care for the possibility of failure to pay up the other party. This practice can often be detected by examining the amount of the receivables. If they are too small for the normal business of the concern under consideration it may indicate that receivables have been discounted.

Notes Receivable are presumably those notes owing by customers, good and collectible, not pledged or sold. An analysis of this item always raises the questions:

(1) Are any matured notes included?
(2) Are the notes free from liens?
(3) Are the notes from other than trade debtors?

Sometimes notes receivable are regarded as a sign of weakness. This is true when notes are not customary in the line of business under consideration or when they are secured by collateral in the form of real estate or securities because this takes them out of the liquid class. It is often a point of suspicion when neither notes nor open accounts seem to dominate the

books. Notes which have matured without payment ought to be carried in a dishonored notes account or charged back to the personal account of the debtor. Discounted notes are a contingent liability and should show on both sides of the statement in that they represent hypothecated assets. It must always be remembered that a bad note under discount is really a note payable. Stock subscriptions are sometimes carried under notes receivable. This is a bad practice as such a document has nothing to do with a payment for merchandise but is a promise to bring in capital.

Trade Acceptances Receivable refer to those bills of exchange which have been "accepted" by the payee. The contingent liability should always be indicated in the analysis of this item. Trade acceptances should receive the proper accounting treatment in accordance with the best advice of the auditor.

Merchandise refers to the stock of goods bought and sold by the concern. These goods are under the control of the owner; they may be in the store or the warehouse, or in certain cases, out on approval with a prospective customer. The property statement is the principal source from which to gain the necessary knowledge for determining the customer's worth. Standard practice demands that this valuation be figured on the basis of cost or the market, whichever is the lower. The quality of the inventory must be determined by an examination of its physical condition and its salability. It is sometimes necessary to check prices by comparing market prices with purchase invoices. Large concerns sometimes send out their own representatives to appraise inventories as well as to audit the books of concerns asking for credit.

A credit manager will often find it desirable to measure inventory by means of the gross profit test. This test may be illustrated as follows:

Sales Previous Period	$100,000	
Gross Profit	27,000	
Rate of Net Profit 27%.		
Sales Present Period	110,000	
Rate of Gross 27%	.27	
	$7,700.00	
	22,000.00	
	$ 29,700.00	Gross Profit

Sales Present Period	$110,000
Minus Gross Profit	29,700
Cost of Goods Sold	$80,300
Opening Inventory	75,000
Purchases	90,000
Other Costs	5,000
	$170,000
Minus Cost of Goods Sold	80,300
Inventory by Test	$ 89,700

If the inventory given varies greatly from the amount derived by this test, it is a subject for further investigation.

Other Quick Assets might include supplies of a nature which makes them easily salable or well known bonds and other marketable securities. These items must always be subject to individual judgment.

Fixed Assets: The fixed assets of any business cannot be expected to furnish payment of accounts until such time as a going concern has gone out of business. Fixed assets are not intended for sale but represent capital used in the business for the creation of economic goods. Credit men customarily discount the valuation of such fixed assets by 50 per cent in order to be absolutely safe in forced liquidation. In the case of an application for an extensive line of credit, appraisals are

sometimes made and the statements of appraisal companies are frequently offered by mercantile creditors as having been used by investment bankers for the sake of securing investment credit. The importance of the building, machinery, and equipment used in the business is one which brings up questions of location, permanency, obsolesence, etc. It is well to see whether or not quick liabilities have been incurred on the basis of capital investments. Ordinarily, surplus, and not working capital should be used for such expenditures and a firm is likely to find itself in difficulties if all its working capital is poured into fixed assets. Fixed assets are not acceptable as a basis for obtaining loans under the Federal Reserve Act, although they can serve as a basis for investment credit. They may serve as a protection to the credit man for current accounts but in the long run the mercantile creditor wishes to avoid the use of such assets for credit purposes and desires to have all of his accounts based upon self-liquidating transactions which will bring money regularly to his house.[1]

Machinery and Fixtures: This is of course a very good asset, though subject always to a yearly depreciation. If, however, this item is made up of special machinery, small tools or old machinery, the depreciation to which it is subject is heavy, and it may be worth little more than scrap iron. In these days of progress and of frequent new inventions in every line, machinery considered to be a good asset may shortly be worthless by the invention of some new machine. It is not uncommon to see machines that cost thousands of dollars scrapped to make way for something more efficient in the way of labor and time-saving devices. In liquidation of an insolvent estate, if the plant can be sold as a going concern, machinery and fixtures may bring a fair percentage of their

[1] A person interested in credit can profit greatly by reading carefully such a book as *Auditing Theory and Practice* by Robert H. Montgomery. While the auditor is interested in a technical method for checking all accounts before he certifies to a statement, many of the points which he brings up are worthy of consideration on the part of the credit manager.

cost, but if it is necessary to dismantle the plant, creditors often get only a few cents on the dollar.

Machinery and equipment are frequently purchased under lease agreement or subject to chattel mortgage. Many states now require such conditional sales agreements to be recorded, and where these items in a statement are of some moment this feature should not be overlooked. Sometimes statements are prepared showing as an asset merely the equity in such equipment. Such an asset is, of course, practically worthless in liquidation. Where it is deemed advisable, the receiver will sometimes, if the equity will warrant, pay the balance and secure title to the asset. Small tools, counters, shelving, show cases, etc., are of little value as assets in liquidation.

Land and Buildings: Real estate is an excellent asset if the equity is sufficiently large. However, where a small dealer shows amongst his assets property valued at $5,000.00 with a mortgage for $4,000.00, the equity is so small that on a forced sale there would be nothing to depend upon as an asset. Properties listed at today's values will also be subject to considerable reduction in a few years, both through ordinary depreciation and because high values are sometimes temporary and decline with a decline in labor and building materials. The type of buildings must also be considered. In case of failure, would the buildings be good for some other purpose, or would they have to be wrecked and sold as second hand building material? Other pertinent questions to be considered are: Has the concern good title to the property? Has the deed been properly recorded? Are there mortgages against the land or plant? How old are the buildings? What is the state of repair of the buildings? What kind of construction? Are there unpaid taxes, or liens of any kind against the property? Is the property properly insured? Is the property being depreciated on the concern's books, and if so, what is the rate of depreciation used?

Other Assets may include a variety of things, but the items most commonly found are those of a more or less intangible nature such as good-will, patents, trade-marks, copyrights, etc. They hold a value in a going concern. Good-will oftentimes has a sales value but in order to have such a sale it must necessarily give to that concern an earning power in excess of that which it would naturally have because of its management and because of the capital invested. The credit manager will be wary of extending credit on the basis of any of these items.

Liabilities.—In the term "LIABILITIES" we include all the offsets of the statement of property owned. Here is indicated what is owed by the individual proprietor, the partnership or the corporation. The most important thing for the analyst to remember is that on this side of the balance sheet the amounts are more likely to be under-stated than over-stated. Sometimes the items do not get onto the books. It is important that all current liabilities be clearly distinguished. Any payment due within 90 or 120 days, depending upon the nature of the business, should certainly be considered current. Cash must be depleted in order to meet the obligation. The standard statement separates current liabilities into three groups. The first indicates the accounts, trade acceptances and notes payable for merchandise.

Accounts Payable: In connection with accounts payable it is desirable to ask whether or not this item is disproportionately large as compared with merchandise and receivables on the asset side. It is also important to know whether or not any of these accounts are overdue. When at all possible the accounts payable item should be divided into "not due" and "past due" classifications but in many lines of business not over 25% of the reports can be secured in this form. Whether or not the statement comes in with a distinction between the two items,

accounts payable must be compared with the merchandise item on the asset side together with the receivables, taking into consideration terms of sales or purchases and the line or character of business under consideration. This comparison may suggest the necessity for further consideration and the credit manager must get more information and if necessary ask the credit seeker for an explanation of the distribution of the items. Accounts payable should represent regular trade obligations. It should not include obligations of affiliated or subsidiary concerns or of directors or officers, or employees or relatives. Another question to be determined, and often a very serious one, is whether or not any collateral or preference has been given to any creditors of the concern. This is usually a matter that is discovered too late in troublesome cases or when substantial amounts of credit are to be extended and the margin of safety seems to be small. It is an exceptionally important point to investigate.

Notes Payable: Notes payable are properly divided as to notes given in payment of merchandise, notes to banks and notes to friends and relatives. Notes to friends and relatives are naturally a sign of danger but it must not be forgotten that many business enterprises were originally financed in this way, and of itself the fact need not arouse suspicion.

If notes are given for merchandise and it is not the usual practice of the concern to pay bills in this way, it is an indication of overdue accounts and if large amounts are shown it should be carefully investigated. If notes are given to banks the question should arise as to whether or not they are secured by collateral or endorsed or guaranteed by individual interests. If there are notes to be sold on the open market then the specific use to which the money was put should be learned, and the asset checked against the sum of the notes. Sometimes this item does not show the full amount of notes payable, notes

receivable having been deducted. Borrowed money should not be used to pay dividends.

The terms and conditions of these notes should also be examined. It must be considered whether the maker has in his business any long-term indebtedness, any mortgages or bonds, etc., outstanding. If he has not, and his business is one that shows a good profit, the chances are that he is putting this money into permanent assets of the business and plans to take care of these obligations out of its profits rather than to create long-term indebtedness. This might be considered as a favorable indication, with the proviso, of course, that he does not impair his working capital in so doing.

Money Deposits: These often appear as a liability though if there is any considerable sum an offsetting asset is usually found. Subsidiary companies often make large deposits for various reasons with the parent or holding company. Employees often deposit money with their employers for safe-keeping or for investment purposes. In such cases there would be an asset item under the proper heading to offset this liability. Again, companies, especially foreign ones, will make advance payments for contemplated orders and deliveries when exchange rates are favorable. When a statement includes items of this sort, amounting to a large sum of money, proper inspection should be made of the asset side of the statement to determine what has become of this money. If there is no item that particularly takes care of this liability and there is a possibility of the money having been used in the business, the matter should be thoroughly investigated.

Accrued Liabilities: These include all such items as those included in amounts owing for wages and salaries, for taxes, for rentals, or for insurance premiums, payment for which is not yet due. Care must be taken in connection with these accrued liabilities in relation to a going business for they frequently do not appear in the financial statement or report reach-

ing the credit man. If there is an outstanding bond issue, or mortgage, the interest item is often a serious one and frequently slows up the payment of bills on interest or retirement dates.

Contingent Liabilities: These are dependent upon the development of certain conditions or circumstances. In other words, it is a possible obligation which may become a very real one. There are many of these contingent liabilities to be taken into consideration in connection with the analysis of a financial statement for credit granting purposes. One that is frequently overlooked in the analysis of financial statements is that arising out of a guaranty or warranty of goods. Notes receivable afford another source for contingent liabilities of considerable consequence, especially if these notes have been taken in payment of overdue accounts and therefore represent, as they often do, quite a percentage of uncollectible accounts.

Endorsement of commercial paper for subsidiary companies or for the accommodation of others is also an item that needs to be carefully watched. This has sometimes put the endorser in a very embarrassing position. If a firm or individual is shown on a statement as having become the endorser or guarantor for another, the conditions surrounding this liability should be carefully investigated to ascertain what effect it might have upon the payment of the account if the party endorsed should default.

If consignments of material are being received by a concern, this must be taken into consideration, as the goods may appear in the merchandise item as an asset and not be shown among the liabilities. Tickets and coupons sold in quantities are a source of contingent liability. The funds from the sale of these items are sometimes included in the cash item of a statement, but the liability of the company remains on the tickets or coupons until they have been used.

Accounts receivable, pledged, assigned or sold are another

source of contingent liability. Contracts for future deliveries of materials, and provisions for allowances on returned containers where the price of these containers has been included in the invoice are other contingent liabilities. Under these circumstances the full amount of such shipments would show in the accounts receivable, but if the containers were returned in any considerable quantity, the return allowance would be a source of liability for the corresponding amount.

Pending lawsuits and judgments where appeal is taken to a higher court; orders for future delivery of goods on a falling market; ownership of real estate adjoining a town where developments may necessitate the owner paying for under-drainage, paving, etc., are other sources of contingent liabilities.

Fixed Liabilities: Debts secured by mortgages on land or buildings, debts secured by chattel mortgages or other liens, debts secured by judgment and other liabilities which cannot be classified as being quick are considered fixed.

Bonded indebtedness consists of obligations issued by a corporation payable at some future date, usually, though not always, secured by a mortgage on real estate or property of the company, this mortgage or deed of trust being usually made out to a trustee for the benefit of the bondholders. It is a frequent requirement that definite installments be set aside as a sinking fund to meet these obligations. Therefore, in the analysis of a financial statement for credit granting purposes, the conditions of the bonds and mortgage should be looked into and preparation made to meet the conditions. An analysis must be made to see whether the earnings of the business will take care of the installments when they become due or whether there is any likelihood that the payments will be made from funds that should remain as working capital in the business. If the latter is the case, the credit manager of a concern supplying merchandise to this house will find that accounts payable for merchandise have been increased, that he

as a creditor has been asked to wait for his money and that he will probably be required to grant an extension, thus becoming a participant in the concern's business, inasmuch as he has been asked to furnish capital.

Surplus or Profit and Loss Accounts.—Surplus or profit and loss accounts furnish an interesting field for investigation. An account of this sort presumably shows the equity belonging to the stockholders over and above the par value of outstanding assets or the difference between assets and liabilities in case of a partnership or an individual proprietorship. The surplus amount may or may not be an earned surplus. It is often largely the result of an estimate or a series of estimates and many times has been increased or decreased by the entry in the company's journal at the direction of the board of trustees or officers. The sources from which a surplus account may spring may be listed as follows:

Accumulation from other businesses absorbed.
Sale of the company's own securities above par.
Sale of assets over book value.
Revaluation of assets.
Earnings.

If it is suspected that a large surplus account is not the result of earnings out of the business to which credit is to be given, its source must be learned. A close scrutiny may make it vanish into thin air, revealing that it is merely the result of some one's imagination set down in dollars and cents. If possible these accounts should be compared from year to year. If there has been a very marked increase or decrease, the reason must be found. If there is any reason to think that dividends have been declared and paid out of surplus arising from sale of stock, thorough investigation is essential.

Supplementary Financial Information.—The same standard property statement requests a large amount of supplementary information, most of which is self-explanatory, or the items of which are emphasized elsewhere. This supplementary information covers such subjects as the character of books kept by the credit seeker, the amount of various types of liens, claims, judgments, etc., the banking connections, the location and kind of business, the previous business experience of the credit seeker, the insurance of various kinds carried, the analysis of the profit and loss statement, a record of the land and buildings giving detailed information as to title, description and location, book value, assessed value and amount of incumbrances, and the names of concerns from which principal purchases are made.

Net Worth and Credit Capacity.—The financial statement is the capital analysis of a credit risk; to know what a man is worth from the capital standpoint is to know the difference between his assets and his liabilities. Credit capacity, however, is not necessarily dependent upon the quantity of capital which a concern has, but rather upon its form and condition. To decide whether or not credit is to be given is not to ask alone what is the total net worth, but to ask how that net worth is distributed among all the assets, particularly those current and available for the payment of month to month bills incurred in the regular transaction of the business. To analyze relationships between assets and liabilities and to determine credit risks is to make analytical comparisons of significant ratios.

Comparative Statements.—The financial statement of a particular firm or corporation as it stands alone without a record of the past is incomplete and often gives false implications. If, however, a credit manager can bring before him a

group of statements covering a period for two, three, four, or five years and can arrange the various items of all these statements in a comparative way so that indications of progress and retardation can be tabulated, much more definite information as to credit standing can be secured. The use of comparative statements in connection with ratio analysis is to be indicated in the next chapter.

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CHAPTER XIII

ANALYTICAL COMPARISONS OF SIGNIFICANT RATIOS

Ratio Analysis.—Financial statements are full of significant information if the analyst will but examine them and compare them. An adequate use of figures available from balance sheets and income statements involves a comparative study of various items on the same balance sheets and income statements and on those of different dates. Credit men as well as managing executives and investors should know how to study properly the statements of the financial structure of the concern. It is said that study of the financial record makes possible the measurement of 25% to 45% of a credit risk. We are indebted to Mr. Alexander Wall in his report prepared under the general supervision of the Division of Analysis and Research of the Federal Reserve Board for pioneer work in this field. He attempted to outline some sort of indicator in credit work with a view to developing the old "2 for 1" rule involving the requirements that the subject's statement must show at least $2.00 current assets for each $1.00 of current liabilities. If this 2 for 1 rule could be applied with more or less satisfaction it was thought that it ought to be possible to make a comparative study of other ratios between various items of the financial statement and current material which would be valuable. If 25% to 45% of a credit risk can be estimated by a system of comparative analysis it is worth the attention of the credit manager even though all must realize that in the final analysis the financial statement is merely one source of information and constitutes only one basis for judgment in credit granting.

Ratio analysis has as its aim the development of norms or "measuring sticks" which can be used in the analysis of a company belonging to a certain group or classification, on the basis of which comparisons may be made with companies under consideration engaged in the same line of business under similar conditions. The purpose of such analysis is achieved by comparing items on the basis of their proportionate importance to each other rather than of absolute amounts. It is easier to understand that the current assets of a company are twice the current liabilities if we express it as 2:1 or 200% or if we turn it around and say that current liabilities are 50% of current assets than if we merely say Current Assets $1,762,426.24 against Current Liabilities of $881,213.12.

It is not intended or suggested that any one credit manager will ever work out all the ratios for any one company, or any one ratio for every company which has an account on his books. In this chapter we merely plan to set up a number of ratios, some of which at some time or another will be found applicable in the analytical work of the credit manager.

Preparation for Analysis.—Various combinations of items and various ratios have been devised from time to time in order to emphasize the information which the financial statement presents to the thoughtful analyst. We shall indicate here one which has been developed and used in the analysis of typical industrial organizations.

It is very important that in every case the different terms used should mean the same thing. The analyst must set up certain qualifications for each of the items and be consistent in all of his work, as inconsistency on this point would make the analysis valueless. In every case reserves must be carefully considered in order that comparable things may be compared. The various types of reserve accounts may be grouped under three headings:

(1) Evaluation
(2) Liability
(3) Appropriation

Evaluation reserves have to do with all of those accounts which are set up as offsets to the book value of various kinds of assets as for instance, depreciation, reserve for bad debts, intangibles and organization expense. Each one of these accounts must be deducted from the asset itself in order to have a true condition of affairs.

Liability reserves include those for taxes, judgments, etc. Liability reserves may be set up by the estimated recognition of a liability which must be met within a definite period of time.

Appropriation reserves are those which are set up on the books in order to take out of the surplus account amounts which the management expect to be spent for other purposes and not to pay out in dividends. For instance, if a concern expects to put up a new building or buy new machinery and wishes to set aside certain amounts in the form of appropriation reserves for this purpose it decreases the surplus account by the amount set apart and protects the assets of the business for the future.

Another essential step in the preparation for analysis is the investigation of the accounting procedure by which the statement was created. Not only should the standing of the audit firm be beyond question, but the certificate itself should be read in order to fully understand the scope of the audit. Many credit managers have a definite plan of "scaling" accounts, reducing various asset items in particular lines of business by certain percentages and increasing liability items in order to be conservative in their evaluation of financial statements.

Classification of Ratios.—Many different classifications have been found helpful. Credit managers will select from

the following comparisons those which give light on a particular credit risk:

Static Relationships

(1) The Current Ratio
(2) Receivables to Inventory
(3) Total Debt to Net Worth
(4) Current Liabilities to Net Worth
(5) Net Worth to Fixed Assets

Capital Relationships

(6) Current Assets to Total Assets Employed
(7) Fixed Assets to Total Assets Employed
(8) Other Assets to Total Assets Employed
(9) Current Liabilities to Total Assets Employed
(10) Long Term Borrowings to Total Assets Employed
(11) Net Worth to Total Assets Employed

Velocity Relationships

(12) Sales to Receivables
(13) Sales to Inventory
(14) Sales to Net Worth
(15) Sales to Fixed Assets
(16) Sales to Total Assets Employed

Measures of Earnings

(17) Net Profit to Net Worth
(18) Net Profit to Sales

Measures of Costs of Capital

(19) Cost of Borrowed Capital
(20) Cost of Total Assets Employed

The methods of figuring the ratios may differ. Some may find it more convenient to use one term as the divisor and some the other. The only thing necessary is to be consistent. The two methods are worked out in only a few cases. The reader may make his own applications.

STATIC RELATIONSHIPS

These static ratios involve comparisons of existing assets or liabilities. It might be said that these ratios are such as are apparent by a photograph of the business as it stands at a particular moment with reference to what is owned and what is owed. This is contrasted with the velocity ratios to be studied later. The velocity ratios may be best described by suggesting a moving picture of the concern as it carries on its operations.

(1) **The Current Ratio.**—This ratio is an expression of the relationship between the current assets and the current liabilities. This comparison is more commonly made than any other and is known in practise as the "two for one" ratio, meaning that current assets are twice as large as current liabilities. This may be put in another way. For every dollar of current liabilities there are two dollars of current assets shown on the statement. This is the working capital ratio, and as such it is very important to know that the items from which the computation is made are strictly current, and that the questions raised in the preceding chapter concerning current assets and current liabilities have all been answered. A point that must be constantly kept in mind is that the current ratio may sometimes be misleading unless the sources of the change are clear. All of the changes in items which may affect the relationship between current assets and current liabilities must be considered before it is definitely decided that a mere change in the percentage of current assets to current liabilities is favorable or unfavorable. For instance in certain industries it is essential that comparisons be made with the idea in mind that there is a "low" and a "high" point in that business each year. In another situation it must be considered that in order to get a large cash discount, collections may have been forced

by means of special discounts. Receivables may have been hypothecated on some kind of a re-purchase contract or abnormal processes resorted to in order to make a good statement from the point of view of this ratio alone. The various methods of figuring this relationship have been illustrated previously.

(2) **Receivables to Inventory.**—Strictly speaking this ratio is compiled from two figures which are not comparable. If the inventory is carried as it should be, at cost or market price, whichever is lower, it cannot properly be compared with the receivables which represent cost plus a profit. This ratio alone, therefore, does not mean a great deal. Its chief significance is the light which it sometimes throws on fluctuations in the current ratios, particularly in connection with possible speculation in inventories.

If, from year to year, we find an increased proportion of receivables as compared to merchandise, we ought to expect to find a rising current ratio. If, on the other hand, we find a decreased proportion of receivables as compared to merchandise, we ought to expect to find a declining current ratio. In other words, this ratio is a check on the current ratio inasmuch as it may show that a change in the current ratio either up or down may have occurred through changes as explained above. Beyond this it is of little value.

This ratio may be obtained by dividing the total receivables by the total inventory of merchandise. If the receivables amount to $540,024 and the inventory is figured at $3,046,725 it is found that the receivables are 14+% of the inventory. The same idea may be expressed by dividing the inventory by the receivables. Then we would say that the inventory was more than five times the receivables. Other things remaining the same, a change from 14% to 20% or from a multiple of five to a multiple of three would be an unfavorable change in posi-

tion and would indicate an increase in the risk. This is one of the best ratios to emphasize the fact that other conditions in a financial statement may vitiate the conclusions drawn. For example, in case a more liberal credit policy had been adopted, with a wider margin of profit, the increase in receivables might be an indication of strength.

(3) **Total Debt to Net Worth.**—Capital which is invested in an industry comes from two sources: the owners of the business and the creditors of the company. It is very seldom possible or desirable for any one man or even a group of men to finance a business entirely. Therefore, it becomes necessary to borrow funds in one form or another. Such financing may be in the form of bond issues, bank loans, or credit extended by commercial houses with whom the company deals. Total debt includes all liabilities, both long term and current. Net worth is obtained by calculating the difference between the total assets and the total liabilities. To obtain the ratio divide the total debt by the net worth. Thus with a total debt of $26,744 and a net worth of $53,401 the result would be 50+%, indicating that liabilties were only 50+% of the net worth. If the net worth were divided by the total debt, the result would express the same idea in different terms, *i.e.,* that for every dollar of debt the company had a net worth of almost two dollars.

A comparison of this ratio over a period of years will show to what extent the company relies upon its creditors. As the total debt to net worth ratio rises the risk is increased because of the fact that if the creditors should lose faith in the future of that industry it would cause a larger and larger amount of the total assets to be used in the concern. There is a warning to the creditor if this ratio is found to increase too rapidly without any indication of some offsetting feature, as for instance, some considerable business expansion which has been

made possible through extensions made by the creditors of the concern.

If the total debt to net worth ratio seems abnormally large it is important to study the current liabilities to net worth ratio to see if that is reasonably low. The total debt to net worth ratio may be high, but if it is found that a large portion of the whole debt is funded through bond issues, mortgages or long term notes the situation is not so serious. If this is the case, the current liabilities to net worth ratio is emphasized as the more important factor.

(4) **Current Liabilities to Net Worth.**—Another ratio is obtained by dividing the total current liabilities by the net worth—or vice versa if it is desired that the second form of expression be used. This ratio is used as a supplement to the preceding one. It does not take into consideration long term or deferred liabilities and by comparison with the total debt to net worth ratio it sets forth the proportion of the total debt which is in the form of long term borrowings. Long term obligations are usually secured, and it is, therefore, usually important to ascertain just what assets have been pledged to meet these obligations.

(5) **Net Worth to Fixed Assets.**—In making a comparative analysis of a business from year to year an increase in net worth is important and makes a good impression. It is also important that a study be made of the relationship between the net worth and the fixed assets. In a period of rising prices there is always a tendency to increase the plant account so that the output may be increased in order to take advantage of the higher prices. If, in making such an analysis, it is found that the net worth has been increased but that the ratio between net worth and fixed assets has declined, it very likely means that the plant account has been increased more rapidly

than is warranted by the normal growth of that industry. This may produce a situation that will result in a lack of working capital for taking care of the working needs of the business.

It is a generally accepted fact that the fixed assets should be largely provided for out of funds furnished by the owners of the business. Current obligations should rarely be incurred for the acquisition of fixed assets. In the first place, it is not considered good business practice and in the second place, under the Federal Reserve Act, only such paper is eligible for rediscount as has been used to produce funds for commercial purposes. The establishment of this ratio comparison reduced to percentages shows us what proportion of the net worth is left after the fixed assets have been financed. The balance can, of course, be used in the current operating features of the business.

CAPITAL RELATIONSHIPS

The term Capital Relationship is used to designate the classification of the different items on the asset and liability sides of the balance sheet. These classifications are expressed with relation to the total amount of the assets employed in the business. The total assets employed, considered as 100%, are used as a basis.

(6) **Current Assets to Total Assets Employed.**—This ratio indicates the percentage of the total assets used in the form of liquid assets, consisting principally of receivables and inventory. About the only service which this ratio renders is its indication of questions to be raised concerning other ratios. Any change from year to year is a subject for inquiry.

(7) **Fixed Assets to Total Assets Employed.**—It is important to study this as well as the preceding ratio over a period of years in connection with some of the velocity ratios. It is well to note increases or decreases in these ratios and to ascer-

tain whether the ratio between these two items and sales has been influenced accordingly. That is, if it is shown that the same amount of sales can be made with a smaller investment in fixed or current assets the decrease is justified, or, stating it reversely, if an increase in the fixed or current asset accounts results in proportionately greater sales the increase is justified.

(8) **Other Assets to Total Assets Employed.**—An analysis of the asset side of a balance sheet will bring out the fact that industries do have definite characteristics as to the manner in which their funds are invested in the business. It depends upon the industry as to what the proportion of fixed and current investment shall be. The financial structure of a company should fit its particular business and any wide digression from what it ought to be will very shortly show its influence in the profit and loss account. Also, when a company is found to vary a great deal from the average, it will be a warning to investigate further to find out whether or not the deviation is justified.

(9) **Current Liabilities to Total Assets Employed.**—The proportion of capital a company may secure through current borrowings is limited somewhat by the amount of its current assets. There is a tendency to bring the current assets up to a point where they will support the current liabilities from a credit standpoint. The capital for the fixed assets and adequate net working capital of the company should be supplied by stockholders' investments or obtained through long term borrowings. From which of these two sources a business is to secure its permanent investment capital is left largely to the discretion of the concern itself. Among industrials it is found that very little of the permanent capital requirements is secured from long term borrowings.

(10) **Long Term Borrowings to Total Assets Employed.** —James H. Bliss has stated that "among industrials, stockholders' investments on the average represent about 70% of the total capital assets employed. About 15% of their requirements are secured from long term borrowings, and 10% from short term borrowings." The experience of the credit analyst as his work continues from year to year, will enable him to develop a norm for particular industries which will suggest investigation when there is serious deviation from the standard.

(11) **Net Worth to Total Assets Employed.**—This relationship expresses the proportion of the total assets employed which is actually owned by the proprietors of the concern. In other words, it is the equity which the owners have in the business. No credit manager is interested in extending credit where the equity is too small. What the limit should be can be determined only after a comparative study of the figures for many companies.

VELOCITY RELATIONSHIPS

The five ratios which follow may be defined as ratios which are made up of comparisons of the sales figure with certain asset items, to indicate the speed with which amounts invested in receivables, inventories, and capital are turned in the regular run of business.

(12) **Sales to Receivables.**—In the discussion of the current ratios we used receivables as one of the factors from which to determine the ratio. The purpose of this ratio is to show how liquid the receivables are, in other words, to state the turnover of the receivables. This is a measure of the economy observed in the use of capital tied up in receivables. It must be remembered that a business has to pay some one for the use of all such capital; for borrowed capital it pays interest,

and for stockholders' investments it pays dividends. On the other hand, the use of this capital is as a rule extended free to the customers. It is, therefore, important to see that the receivables are kept at a figure which is conducive to the greatest amount of business with a minimum loss and expense.

It is necessary to know the terms of sale of a concern in order to ascertain what the amount of the receivables should be. If the terms of sale are "30 days" the amount of the receivables carried on the books at any one time theoretically should not exceed thirty days' sales. This result may be expressed in one of two ways. It may be stated as a 1200% turnover of receivables or as 30 days' sales. To obtain this ratio divide the total sales by the total receivables. Thus, if we find a decreasing sales to receivables ratio it signifies that the receivables are becoming less liquid and vice versa. The following table shows how this ratio may be interpreted in terms of days:

2400%	–	15 days
1200%	–	30 days
800%	–	45 days
600%	–	60 days
480%	–	75 days
400%	–	90 days
300%	–	120 days

(13) **Sales to Inventory.**—This ratio is an indication of how fast the stock of goods on hand is sold out and replenished. In theory and practice it is somewhat similar to the ratio discussed. The usual way to compute this ratio is to divide the sales by the average annual inventory (averaged monthly). The more accurate way is to divide the cost of sales by the average annual inventory, but this is in most cases difficult because it is usually impossible to secure the cost of sales figure. The first method gives an approximation which is accurate

enough to be valuable and if the spread between the cost and the selling price are known the difference between them can be modified accordingly.

The theory on which the analysis is based is that the greater the rate of turnover at a given margin of profit on each turnover the greater will be the net profit at the end of the year. The type of industry in this case also determines the rapidity of the turnover of inventories. An unusually rapid turnover in any business would suggest that it would be wise to look into the source of information from which the inventory was obtained. A very rapid turnover may indicate danger. For instance, a mattress manufacturing concern located several thousand miles from the source of its raw material, some of this coming from China and some from points on the other side of the continent, would find itself in serious difficulties if at any time difficulties in transportation prevented a steady inflow of raw materials.

(14) **Sales to Net Worth.**—This ratio represents the activity of the capital invested in the business by the owners. At a given rate of profit the profits will be greater on a fixed capital investment for each increasing unit of annual sales. If the sales to net worth ratio is an increasing one the activity of the invested capital is greater, and with the same margin of profit the earnings should be greater. Sometimes this ratio increases too rapidly and may indicate an over-aggressiveness in developing sales in proportion to the capital invested. This may result in a top-heavy financial structure. As a rule an increasing sales to net worth ratio indicates a more profitable use of capital.

(15) **Sales to Fixed Assets.**—This ratio is similar to the sales to net worth ratio in that it indicates the activity or

efficiency of the investment in fixed assets. It should show whether or not an increase in fixed assets is justified by a proportionate increase in sales. The importance of this arises out of the fact that fixed charges which accompany the investment in fixed assets are practically the same whether the business done is large or small. Other things being equal an increase in the volume of business would result in greater profits.

In connection with this ratio as well as some of the others it is well to remember that with a changing level of prices it is often more accurate to make comparisons of sales on the basis of units of volume rather than on the basis of dollars.

(16) **Sales to Total Assets Employed.**—This measures the efficiency with which the total assets employed in a business are utilized. It includes turnover of inventories, accounts receivable and plant investments. The turnover of total assets used should be based on the annual net sales and average amount of capital (averaged monthly) used in operations. The average amount of capital used in operations should not include investments which may have been made and which may have an income entirely separate from that derived from the operation of the business. Usually this ratio has to be calculated on the basis of the capital used as it is shown in the balance sheet at the close of the fiscal period. Although not absolutely correct, that is near enough to be valuable for any ordinary analysis.

MEASURES OF EARNINGS

The term measures of earnings, refers to the comparison of the proportion of the net profits, gross profits, and operating profits in relationship to various items found in the balance sheet and income statement.

(17) **Net Profit to Net Worth.**—This is the real measure of the earning power of the business from the stockholder's point of view. It is the final summing up of all other relationships and measures of business efficiency. It results from, and includes, all other relationships. A business, in order to attract capital, must show a net earning on its net worth in excess of the rate which is being paid on bonds and preferred stocks. If this is not the case, then investors will seek other channels into which they may direct their capital. In other words, this ratio will express the rate in per cent above or below the average rate of interest which the enterpriser secures for the use of his capital. If the ratio is higher than the average rate of interest it represents the compensation which the enterpriser gets for the risk which is incurred. If it is lower than the average rate of interest the enterpriser will attempt to place his money in other industries which do pay commensurately with the risk taken.

(18) **Net Profits to Sales.**—This is the measure of the profit on turnover, distinguished from the net profit in relation to net worth. These two ratios should not be confused although they should be studied together. A high return on sales does not necessarily mean a high return on the investment, and vice versa. A low return on sales does not necessarily signify a low return on the investment, for the reason that the net return depends upon the amount of the investment.

MEASURES OF COSTS OF CAPITAL

This term represents a calculation of the rate of interest which employed assets actually cost based on interest charges and all additional costs in connection with the financing of the business.

(19) **Cost of Borrowed Capital.**—The cost of borrowed capital is computed on the basis of the average amount of funds which are borrowed during the year. All funds upon which interest is paid should be included in this amount. To the interest charges should be added all costs entering into the borrowing of the funds, such as commissions, expense incurred in connection with security issues, etc. This total amount divided by the average amount of borrowed funds will give cost of the borrowed capital in percent. Too much borrowed capital is a danger sign and reflects upon the credit standing of the concern.

(20) **Cost of Total Assets Employed.**—This statement is a measurement of the costs of all of the assets utilized in the business, and is based on all capital used no matter from what source it is derived. It is calculated in the same manner as the cost of borrowed capital, except that costs include a fair competitive return on the net worth of the business, and the divisor is the average amount of total assets employed.

EXAMPLE OF RATIO ANALYSIS

In order to indicate the method of using comparative statements in this way, a hypothetical case involving most of the points just discussed has been set up. It is emphasized again that in no one credit problem will all of these comparisons be made. Each risk will call for a selection to meet a particular situation. The question in this case is to indicate wherein the credit strength seems to have increased and wherein it has decreased during the period. The financial statements as arranged on a comparative analysis sheet for five years read as follows:

Statement	1918	1919	1920	1921	1922
Current Assets	$ 92,462	$105,911	$168,186	$348,057	$288,317
Current Liabilities	34,756	24,302	56,564	188,964	180,372
Receivables	41,078	33,728	71,818	149,366	160,768
Inventories	50,874	62,100	80,788	176,416	117,578
Total Debt	38,756	28,302	60,564	194,964	182,372
Net Worth	67,906	100,057	130,000	152,560	133,750
Total Assets	111,162	131,708	193,178	375,157	328,061
Fixed Assets	13,600	18,447	18,377	20,552	33,262
Other Assets	5,100	7,350	6,615	6,548	6,482
Long Term Borrowings	4,000	4,000	4,000	6,000	2,000
Sales	52,432	555,469	861,261	869,997	641,848
Net Profit	19,142	37,420	56,211	14,406	3,147

Expressed on a percentage basis the ratios read as follows:

Ratio Analysis

Static Relationships

(1) Current Ratio	237	435	297	184	159
(2) Receivables to Inventory	80	54	88	84	136
(3) Total Debt to Net Worth	57	28	46	127	136
(4) Current Liabilities to Net Worth	51	24	43	123	134
(5) Net Worth to Fixed Assets	499	542	707	742	402

Capital Relationships

(6) Current Assets to Total Assets	83	80	87	92	87
(7) Fixed Assets to Total Assets	12	14	9	9	10
(8) Other Assets to Total Assets	4	5	3	1	1
(9) Current Liabilities to Total Assets	31	18	29	50	57
(10) Long Term Borrowings to Total Assets	3	3	2	1	6
(11) Net Worth to Total Assets	61	75	67	40	40

Velocity Relationships

(12) Sales to Receivables	127	1646	1199	582	399
(13) Sales to Inventory	103	894	1065	493	545
(14) Sales to Net Worth	77	555	662	570	479
(15) Sales to Fixed Assets	385	3011	4686	4233	1929
(16) Sales to Total Assets	47	421	445	231	198

Measures of Earnings

(17) Net Profit to Net Worth	28	36	43	9	2
(18) Net Profit to Sales	30	6	6	1	-4

The reader may make his own applications by comparing information under corresponding numbers in the text and in the example given above.

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Part III.—The Credit Department

CHAPTER XIV

PERSONNEL IN THE CREDIT RELATIONSHIP

The Place of the Credit Man in the Organization.—The real credit man is the physician of business. He must keep in constant touch with his clients, or patients, to be sure of the condition of their financial health. He must know what are the necessary facts to be ascertained, and where and how to get them. He must then analyze the case. He must know where and how to look for symptoms of disease. When the facts have been gathered, and the case diagnosed, he must record those facts and his conclusions for future reference. If the symptoms he discovers on a risk he has assumed, later develop seriously, he will be called upon to prescribe a remedy. He must often help nurse his patient, the debtor. He may sometimes have to assist at a financial funeral when he happens to diagnose or prescribe improperly, or when he has tackled a hopeless case.

A credit man must be thoroughly honest; he must be fair in his dealings with every one; he must be sympathetic with the customer in his problems and with the firm in protecting their interests; he must be human, and have a good understanding of human nature; he must be tactful; he must have a good memory; he must have courage to do unpleasant and embarrassing things, when necessary; he must be dignified, yet pleasant and agreeable; and he should be a man—in all that the word implies. Some pretty good qualities are required,—true—but a good credit man finds in the opportunities for service and helpfulness to others, the zest for his daily en-

deavors. To measure up to these opportunities requires ability built upon qualities such as just described. It may be apparent that some of these qualities might often be lacking. But they are qualities none the less essential to real success in this line, and should therefore, if possible, be acquired. How acquire them? "Know thyself!" The student of credit management should analyze himself, find out his shortcomings, and then set about remedying them.

The modern business office finds the credit man head of a department or an officer in the corporation. Often times the credit manager has become the secretary or the treasurer of the company. Such a situation has not always existed. Before the time of the Civil War most business organizations were small and most business was done on a personal basis. The proprietor himself knew his customers personally and made decisions as to credit. With the development of transportation, trade areas for individual merchants increased in size, and the salesmen of the house were the only ones who knew the customer. Then the number of accounts increased so rapidly that the proprietor, in spite of all his misgivings, had to transfer this important duty of credit to someone else, often to the bookkeeper. Whoever was chosen, however, was still expected to depend on the head of the house for counsel. The continued growth of the business, however, demanded further division in many instances, and thus at last the accounting and credit divisions were set up and the modern credit manager came into existence.

Responsibility of the Credit Manager.—The place of the credit man varies with the personnel and the tradition of each organization. He should be the deciding personage on credit questions. Occasionally his judgment will differ from that of the head of the institution; and in these cases the credit man can only put himself on record as having recommended

a certain line of action, and then follow instructions. It is natural in such instances for the credit man to feel that a lack of confidence is placed in him. Instead of feeling, however, that he has reached an unalterable situation, the credit man must seek to ascertain the basic reasons for lack of confidence in his decisions and endeavor constantly to build within the organization the sense of his ability and the real merit of his judgment. The establishment of credit policy is certainly a function of management and should be decided after consideration by all members of the firm, but once established, the administration of that policy ought to be left to the credit manager. It has been said that the credit man is the "safety brake in the credit machine"; naturally when the brakes are applied friction develops.

Functions Performed.—The discussion of the place of the credit man in the organization has indicated in a broad way his functions. The true credit man never divorces himself from the dominant necessity under which all competitive business is transacted—the making of profits. Sales make profits possible and so the credit man must be stirred by the thrills of a successful sales promotion executive. Credit supervision must mean, not the limitation of sales, but the selection of buyers. Thus we may classify the functions of a credit man under three heads: (1) the promotion of sales, (2) the scientific selection of buyers, (3) and the training of the selected buyers in proper payment methods.

(1) **Promotion of Sales.**—The various duties performed in the fulfillment of these functions vary, of course, with the type of business; but in general, the function of the credit man in the promotion of sales consists of: (a) welcoming customers, and (b) making acceptable presentation of the firm's merchandising policy. Psychologically, first impres-

sions are very important. Sometimes merely by his attitude toward the prospective customer or by his presentation of the "House Policy" on credit matters, he may either promote a sale or send the customer elsewhere.

(2) **Scientific Selection of Buyers.**—The second function of the credit man, that of selecting buyers, is somewhat more complicated. He must—

(a) Secure information concerning each credit risk. In other words, he must investigate the character of the man seeking credit, his reputation in other business dealings, and the condition of his business in connection with his capacity to pay in the future.

(b) This information must be verified to the complete satisfaction of the credit man.

(c) When the information is verified and proves to be satisfactory, and the applicant is considered to be a "good risk," the credit is passed, and the account opened.

(d) An accurate record must be kept of the account, so that at any time, the credit man may know exactly the relations of the debtor to the firm.

(e) Supplementary information pertaining to the debtor is often accumulated, for the more the credit man knows about the customer and his business, the greater wisdom he can use in granting extensions and additional credit.

(f) A close study of the relation of economic conditions to the business of the debtor is a very important function of the credit man. By a knowledge of both general and specific business conditions, he is able to act with greater justice and wisdom and foresight than he possibly could command without this very necessary aid to the accuracy of his decisions.

(3) **Training of Selected Buyers in Proper Payment Methods.**—The third function of the credit man, that of training the selected buyers in proper payment methods, is perhaps the most difficult of all. He must select the proper persuasive or coercive methods to induce payment. In other words, he must have such a keen knowledge of psychology, and such a thorough knowledge of the conditions of the debtor's business, that he can deal with his customer in a manner which gains the customer's confidence, and produces results in the form of payments. The credit man is often called upon to act as a teacher of sound credit practice, or as a "business doctor" in connection with weak accounts. This is the credit man's best opportunity for constructive work, for he can advise customers as to the theory and practice of scientific credit. He also has the opportunity to help the weak business build up strong policies, and to help the temporarily disabled business over a difficult place in its affairs, or even over a difficult period of the business cycle.

If these duties are performed, the functions of the credit man as outlined are in process of accomplishment. Each of these is later discussed in detail under the proper headings. Every credit relation must be the subject of the most painstaking search for direct and indirect information and then all must be checked and verified. On the basis of the information at hand, a decision has to be made, in many cases before the investigation is complete. A careful analysis of all information available at the time gives the answer. But this is only the beginning. From now on the account must be watched. Purchases and payments tell a story, and the credit man reads on the ledger page the innermost secrets of the standing of the debtor. As the days and weeks go by the credit man receives letters and reports, selects clippings from trade journals and newspapers, and exchanges information with fellow credit men. Economic reports of various kinds, both government

and private, keep him informed concerning the degree of prosperity in the debtor's neighborhood, and the creditor and the debtor begin to feel that they are in business together. The next steps, necessary to a mutual understanding of all questions of payment, then become easy. If affairs have not been consummated up to this time, the executive and often the diagnostic and healing power of teacher or physician must be called into play to help the debtor back to a healthier condition.

All of this consideration and study should put the credit man in a superior position so far as an intimate knowledge of the economic and financial aspects of his house are concerned and hence he should become especially valuable on this account. He may often be called upon to solve the financial problems of his organization.

Qualifications Desired.—The examination of the functions of the credit man indicates that much is demanded of the individual who would perform them. Many qualifications are essential. As adjectives are difficult to select and classify, the results of a questionnaire will be used to outline these qualifications—a questionnaire answered by thirty-four successful credit managers who indicated in the order of importance the desirable characteristics needed by those responsible for credit. Each characteristic given first choice by any of those voting counted five in the final score, each second choice counted four, each third choice counted three, each fourth choice two, and each fifth choice one. Not all indicated their choice in complete form, but the results are of real merit and indicative of the qualifications desired.

Judgment	61
Knowledge of the work	55
Knowledge of human nature	42
Tact	29
Pleasing personality	27

Common sense	15
Integrity	13
Accuracy	8
Endurance	7
Courage	5
Reliability	3

The grouping was necessarily arbitrary and little meaning can be attached to the fact that one characteristic received a score of 61 as against 13 for another. It does, however, emphasize the prominent needs for credit work. Judgment includes sagacity and perception and the capacity for decision. The majority seemed to feel that the capacity to answer yes or no in a decisive way after scientific investigation was absolutely essential. One expressed it, "The ability to render a quick positive decision," another "Ability to judge the qualification of the credit applicant."

Knowledge of the work included both the general and the technical. Experience was emphasized in about three-fourths of the cases in this group as against training and education, though it was evident that all demanded a minimum amount of preliminary education. Accounting and Business Law were the courses mentioned most. Knowledge of human nature was ranked high by many, while tact was almost universally included but did not always receive a high rating.

Analysis of Qualifications.—(1) Judgment is one of the most necessary qualifications of the credit man. He must be able to discriminate as to the worth of material, to separate facts from suspicions, and to render an impartial but firm decision. A judicial temperament tends to make his conclusions reasonable and sound; and his decisions such that the heads of the firm can have perfect confidence in them.

(2) A knowledge of the work is rated as a very important qualification of the credit man. This seems obvious. Just as a

teacher to be successful must know thoroughly his subject, or as the physician must know medicine and surgery, so must the credit man know both the general and particular fields in which his work lies.

(3) To be able to refuse credit, and yet retain the good will of customers calls for tact and diplomacy. The third function of the credit man, that of training buyers in proper payment methods, can hardly be performed without a sympathy for other people, and an ability to put oneself in the place of other people. This is tact—and the credit man who remembers his customer's strong points and weaknesses, their interests and prejudices, will have the good will of all with whom he comes in contact.

(4) A pleasing personality is closely bound up with the possession of tact. The personality of the credit man is shown in the way he welcomes customers, in his attitude toward them, in his treatment of those who are weak, in his sympathy and fair mindedness. The credit man who possesses the somewhat rare quality known as common sense, will find it most useful in drawing conclusions.

(5) Integrity and reliability are very closely connected, and both are essential characteristics of any business man who is fulfilling the highest ideals of his profession. To be honest in his dealings, to be known as trustworthy, should be the aim of every credit man. If the customer knows he will have a fair deal, that his confidence will not be violated, and that the credit man can be depended upon to do and act as he says he will, the customer is more likely to be satisfied.

(6) Accuracy is necessary, particularly in connection with the second function of the credit man. The basis of his decisions in regard to credit risks must be accurate, otherwise his judgment is a result of guesswork and lacks authority.

(7) The credit man should have the courage to endure criticism of his decisions, and yet stand for them as long as he

believes them to be right. It is not always easy to refuse credit when a customer is a friend of the principal of the firm; or when the salesmanager insists that the risk is good. But if the credit man has carefully investigated the case, and has drawn his conclusions from accurate sources, he should be courageous enough to stand the consequences—whatever they may be—of a conscientious decision. It requires even more courage, perhaps, to overrule a former decision when it becomes evident that that decision was incorrect. But fairness to the customer, fairness to the firm, demand that the credit man be of this fearless type.

All the qualities listed in this classification are required in some measure in the performance of each function; some are required more than others. J. H. Tregoe has given us another interesting classification of the desired qualities in a credit man, which includes (1) A studious, searching disposition, (2) A judicial temperament, (3) A knowledge of men, (4) A tendency to strong ideals, (5) A love for the work. These are considered the natural rather than the acquired qualifications. He enumerates the required ones as follows: Thoroughness, concentration, an even keel, firmness, skill in correspondence, imagination, courage, resourcefulness, ability to cooperate, and honesty.

To summarize it might be said that the credit man needs the technical qualifications pertaining to his own particular field, a knowledge of the fundamentals of the science of business and such general qualifications as are involved in character, judgment, efficiency and the understanding of human nature.

Training and Experience.—The preceding sections have indicated to a certain extent what is needed in training and experience. For the man who has an opportunity of formal education, an outline of a desirable course of study may be somewhat similar to an outline of the field of knowledge in which

credit problems are found. Economics, because it deals with man and his "wealth-getting and wealth-using" activities, is the basic science involved in credit transactions. However, "Economics and the other Social Sciences are closely related and mutually dependent. Even when we endeavor to decide the appropriate course of social action in lines in which the motives are mainly economic and in which accordingly economic laws will be a chief guide, we get assistance from History, Psychology, Sociology, Law, Politics, Statistics, Finance, and other studies which deal with man individually or socially." [1]

Economics acquaints the student with the principles of production, consumption, distribution—with the principal facts of modern industrial history—all so necessary to an understanding of our present social organization. Without this understanding, he who attempts to be a credit man will indeed be a failure.

Most of the sciences used in the field of credit are direct outgrowths of economic science. Business finance deals with "the securing and handling of money and credit for business enterprises." [2] It teaches the correct methods of dealing with the most vital problem of every business—that of financing. This knowledge, however, cannot be attained without an insight into the field of "Credit and Banking," when the true nature of money and credit and their functions is investigated. This field of study treats of the bank as a "manufactory of credit," a most important factor in wealth production.

Statistics are useful in the collection and classification of numerical data. They show that human actions are capable of scientific study, and that from the data so classified, certain facts may be compared, related and correlated, and certain conclusions drawn as to probable human actions. The use of

[1] Mills, H. E., *Outlines of Economics*, p. 7.
[2] Lough, W. H., *Business Finance*, p. 1.

statistics in the field of business has enabled us to predict with comparative accuracy certain important changes in connection with the business cycle. These cycle changes are of very definite interest to the credit man, for they materially affect the granting and refusal of credit.

So keen is competition in the present day, so narrow the margin of profit, that the successful firm must cut down to a minimum all waste in production and marketing. This necessitates systems of cost accounting, which analyze expertly "cost per unit," and which point out weak places in the operation of the plant. Several years ago, before business had grown to its present proportions, the credit man came in personal contact with every customer. He could perform his functions through conversation. Now, however, the credit man seldom sees certain customers, and the contact and impressions must be made through correspondence. The credit man, therefore, must know how to convey personality, tact, courtesy, firmness, through the medium of business letters. This ability can be acquired through study of English and Business Correspondence. Credit managers are often called upon to make addresses before credit associations, members of other firms, or perhaps the salesmen of their own firms. Often an excellent message fails because of poor presentation. A course in Public Speaking is very valuable to the credit man who would convey ideas to either large or small groups.

But not every man has the opportunity for so much formal education, and there are many excellent credit men who have perhaps never had definite "courses" in the subjects discussed above. This does not mean, however, that they have no knowledge of these subjects. They have undoubtedly had years of experience in business before becoming credit men, and through experience and wide reading have acquired both practical and theoretical knowledge. The possibilities and capacities of each credit man develop with experience. But behind

this there must be certain qualities of character, certain training in business principles, which are essential to success. Above all, this education and training should be of such a nature that the prospective credit man learns to draw conclusions from the data or lack of data before him. He must learn to read between the lines and be able to develop a complete story from a chance remark.

As the student or beginner looks over the list of subjects of which at least a good working knowledge should be had, he may perhaps wonder how he is to acquire a good knowledge of all these subjects, if he is not already possessed of it at least in part. It has previously been stated that the work of credit and collection management is a profession and not merely an occupation. It *is* just that. It is a work that requires continuous study and research. There is nothing to be gained by attempting to disguise the labors and difficulties that beset the credit man in his work. It is written that "the immortal garland is not to be run for without dust and heat," and nowhere is the statement more true than in credit work. In this work is infinite toil, humiliation, discouragement, obstacles to overcome and pleasures to forego, but in the moral and financial victories to be achieved, in the broadened scope of usefulness, and in ever-increasing opportunities for a successful business career, there will be a crown of recompense; the success so attained will amply repay the efforts expended (and possibly the privations exacted), in preparing and "keeping fit" for this important line of endeavor.

The Research Attitude.—Credit men are learning the value of research. Data of various kinds which can be used in a comparative way help to determine standards of success and failure. The inquiring mind must not only be inquiring, but it must organize its inquiries, and bureaus of business research are today gathering facts on thousands of cases and ar-

ranging them for interpretation. Ratios for a thousand or more firms in similar lines of business furnish a basis by which another man in the same line can judge of his success. Statistical studies of the percentage of slow accounts in various sections of the country indicate territory of major or minor activity. The future holds much for the credit man with a questioning mind.

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CHAPTER XV

THE ORGANIZATION OF A CREDIT DEPARTMENT

Importance of Organization.—It is the lack of organization that causes so many misfits in business and the failure of so many business organizations. A group of people placed in an office or factory with equipment and machinery does not necessarily constitute an organization. It may represent, and often does, only disorganization.

The human body is a perfect organization of human members, equipment and machinery, and we very quickly perceive the inefficiency resulting when the foot is made to do the work intended for the hand, the eye for the ear, or the stomach for the teeth. Just so is a business organization inefficient when the employees, or equipment, or machinery, are misplaced.

Thinking of an organization, let us ask ourselves: What is a Credit Department, a Sales Department, or any other department of a business organization? Each *should be* at once an organization in itself and a unit of the entire whole organization. Is not any department then merely a part of the whole? And yet that *pari,* insofar as its particular functions are concerned, must be an *end* and *means* in accomplishing its work. It must be the *end* for its part, its unit of the work, and the *means* to the whole result to be obtained by the entire business organization. The frequent cause for lack of cooperation between departments of a business organization is the failure to have a thorough realization that each department is only a *means* to the end sought by the business as a whole.

Function of the Credit Department.—After a business enterprise has been properly capitalized and is rendering a service at a reasonable profit by producing commodities whose worth has been determined and measured by "scientific experts" that it may meet proper standards, the credit department finds its work ready. Though the enterprise may produce well and sell largely, it cannot claim to be successful as a *business* enterprise unless its credit division is really efficient in accomplishing the satisfactory completion of the credit transaction. The equipment of the credit department, its organization and the direction of its routine and administration are as important as the equipment of a testing laboratory or the efficient arrangement of overhead conveyors.

With 85% of all the business in the United States transacted through the medium of credit instruments, something of the significance of an efficient credit organization may be realized. Its functions within the commercial organization may be divided as follows: the promotion of sales, the scientific selection of buyers, and the training of these selected buyers in the proper payment methods.

Peculiarities of Its Service.—The credit department is of a pecular nature in that its "scientific experts" cannot secure privacy in a laboratory or content themselves with a complete knowledge of their own plant. They must be able to relate their interests to those of the entire business community. It is not merely a question of production and sales in which the credit department is interested. To a certain extent the department is a watchdog of the treasury, and in that position those who work in it become the coordinators of the "money," "goods," and "men" aspects of the enterprise. The entire atmosphere of the credit organization must be one of mutual helpfulness, guided by a spirit of cooperation based on good faith and confidence in others.

Personnel in Relation to the Department.—The first and most important thing to consider in organizing a business, or a department of a business, is the personnel. Some may fail to agree in this statement, and may place money, or machinery, or perhaps buildings to the fore. Those who do this—and each must judge whether or not this is often true—fail to realize clearly the *end* sought in the plan of the Universe; are losing sight of the fact that living lives is the real *end* to be sought by all organizations. A thorough appreciation of this fact is the greatest factor in building and maintaining an efficient organization.

The Credit Manager by the very nature of his line of endeavor occupies an unique position of authority. He is the one person to say who may purchase from his house on credit, and to what extent, and who must pay cash. It usually proves to be a costly procedure for even his superior officers to overrule him. We are not here concerned with his qualifications; suffice it to say that he must have those which are necessary.

This rather unique position not merely conveys authority, but also imposes responsibilities. Upon him falls the responsibility of seeing that a maximum amount of business is accepted by his department, and that money is collected therefor at a minimum loss in bad debts, a minimum loss of customers in making those collections, and at a minimum expense to the business. To accomplish this there are many duties to be performed, many and varied activities required.

The real credit manager, the physician of business, should keep in constant touch with all matters appertaining to orders or contracts, shipments, payments, cancellation of orders or contracts, claims adjustments, returned merchandise, etc. In fact, all matters relating to customers' relations with his house should be constantly coming before him. If this is not done, there is bound to be confusion and dissatisfaction. If the busi-

ness is small and one man constitutes the credit department, that one man must do all the detail work as well as carry on the more important functions. If it is a large business in which a number of departmental employees are required, then it behooves the credit manager to assign detail work to his subordinates, which will leave him free for the more important matters. He must, either by personally handling details when a business is small, or by reports and charts when a business is large, keep in constant touch with all the activities and relationships of the customer with his house. He must, so to speak, keep his fingers on the pulse of the customer's business, as well as manage his department as a department for his own company.

To go still a little further into detail on the point of keeping informed on customers' transactions, it is important to keep posted as much as possible on the sales of unusual quantities of materials, or sales covering a period of time in advance of delivery. In the latter case the credit man should see that the customer's standing is such as will permit, under normal conditions and sometimes under specific conditions, the fulfillment of the contract, else a serious loss may often be incurred through buying and manufacturing materials that cannot later on be disposed of at a profit. The kind, nature and extent of the business, together with information usually obtainable from the sales department, should enable the credit man to ascertain fairly accurately what a customer's requirements should be, and from his own credit files and his knowledge of the industry concerned, and general conditions, determine the customer's ability to carry out his part of a sales agreement. And, if a customer starts buying much in excess of those requirements, the credit manager should immediately ascertain the reason—often a rising market which develops in the cus-

tomer a speculative streak—and see how it is going to influence his business.

General Plan of Organization.—In order to discharge properly, in a business of substantial size, the many responsibilities of the credit manager, he must have an organization behind him that can be depended upon. Perhaps the best way to describe such an organization and its procedure, is to take as example the credit department of a successful business house engaged in manufacturing and distributing at wholesale and retail, and covering in its activities the United States and Canada.

The chart shown in Figure 23 gives a graphic presentation of such a Credit Department organization:

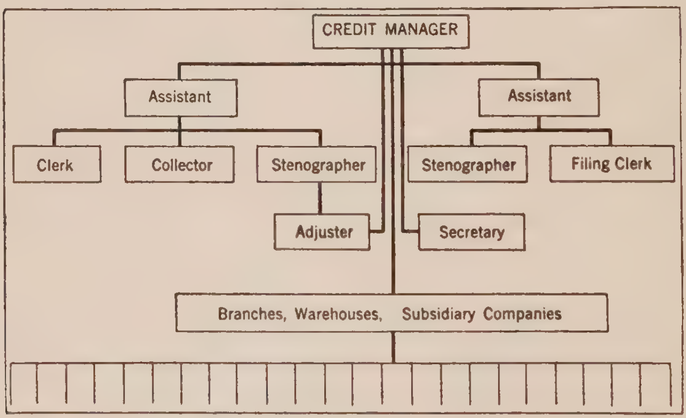

Figure 23. Organization of Credit Department

In explanation of the above it might be well to outline in some detail the work of the various positions indicated. It will be noticed that there are two assistants to the Credit Manager, who are placed directly in charge of definite divisions of the work as follows:

Division No. 1	Division No. 2
Mail and Checks from Customers	Fixing Credit Limits
Checking and Approving Orders	Gathering Credit Data
Following Up Division Accounts	Following Up Division Accounts
Journalizing Bills Receivable Items	Scrutinizing All Contracts
Credit and Correspondence Files	Held-up Order File
Other General Work	Some Personal Interviewing

Working with the two assistants and in direct contact with the credit manager are an adjuster and a secretary whose general responsibilities are as follows:

Adjuster	Secretary
Adjustments	General Correspondence
Equipment Leases	Demurrage and Detention Charges
Auditing and Checking Troublesome Accounts	Statements and Reports
	Credit Inquiries

In addition to the general department are the branch offices, warehouses, retail stores and subsidiary companies. Governed by volume of business, distance and other essential factors, credits and collections are handled at some of the offices, the general credit department merely supervising in a general way from reports (to be later described), while at other branches all credits and collections are handled in detail (in amounts over $50.00) from the central office. At some of the offices volume of business, distance, and other essentials have necessitated a local credit man and a clerk, while at others part of the time of the chief clerk is all that is required.

It should be the policy of every credit manager, as is true in any kind of a permanent organization, to have each person in the department, from himself right down the line, train some one to fill his position. To illustrate from the department above charted as the business has grown, it has become necessary to send an assistant to some branch office. When this has been done, it is a very simple process to move everybody up

a step and employ another clerk, resulting in no confusion or inconvenience, and keeping alive the spirit of hope for advancement and progress—a great factor in any organization.

The Credit Files.—Next in importance to the personnel of a credit department organization are the credit files. If the credit files are not of proper design and facility to meet the needs of the department, the work of the entire organization can be greatly hampered with much loss of time and labor, often resulting in losses, omissions, and duplications that a proper filing system can and should prevent. The credit files should at all times be kept up to date, day by day, should be complete, should always be readily accessible to those concerned; and should also by the use of lock and key be made inaccessible to those who should not see them. They contain *confidential* information about your customers. To permit this confidential information to fall into improper hands, unintentionally, or otherwise, may constitute a breach of credit ethics that may do untold damage, not only from the customer's standpoint, but also in the way of closing up channels for securing confidential credit data on future credit transactions.

A credit file should contain information and records put there for preservation and future reference, that can be found *when they are wanted.* There should also be an absolutely complete filing record of every customer with whom a house has done business, at least for a period of five or six years. In one case alone, because the credit file was complete, a loss was prevented that might have amounted to many times the cost of the entire filing system for all the years it had been operating. The operation of this particular filing system in a specific case will be described a little further on, but the following forms will help make clear at this point the *end* sought.

The first step in the credit file of a customer is the preparation of a sheet like Figure 24.

Cross Reference..

If other than an individual, give names of partners, officers, or proprietor: (Designate Title)

....

....

....

Business, or occupation..................................

Rating: Dun..................Bradstreet.................

Estimated Net Worth: $............... to $...............

Commenced Business.......................................

Incorporated under..............Laws: Dated...............

Authorized Capital $..........Subscribed & Paid $..........

Owns Real Estate $..............Mortgaged $..............

Investment $..............Stock & Equipment $..............

Chattel Mortgages, or Judgments $........................

Banks with...

Trade Experience: (1) ....

(2) ....

(3 ....

References: ....

....

....

Terms ....

Our Limit $............Date: ....

Date of First Order: ....Amount $.......

Special Report............Date.............

Filed in Book No..........Page No..........

Salesman: ....

Other Information: ....

....

....

....

....

Remarks: ....

....

....

....

....

FINANCIAL CONDITION

Year	Assets:	Liabilities	Net Worth

Our Experience:

Figure 24. Customer Record Sheet

When this sheet has been completed it is filed in a correspondence folder that is made up for the customer. There is a particular reason for going to this seemingly unnecessary work. The purpose is to enable the collection correspondent to be individual in his letter writing. It is not possible in most cases for collectors to know customers personally. It is not possible to have a photograph of the customer before your correspondent—if that were practicable, it would certainly help, and be productive of better collection letters; so the next best thing is to place before him a word-photograph of the man. When a form like this is placed in the correspondence folder it enables the correspondent to obtain a good idea of the type of person to whom he is writing, without consulting a separate credit file for information. When the information is in a separate file, it is usually not consulted, with corresponding evil results. But when a "word picture" is before the correspondent's eyes every time he has occasion to write the customer, there is no excuse for writing letters that have no personality.

Filing Credit Data.—The next step is to file the credit data that has been gathered. A great many houses use a vertical file, preparing a pocket envelope with a summary on the outside and placing the data on the envelope. Figure 25 shows one such form:

This form is perhaps most desirable in a retail business or where no duplicate record is made for a general credit file in another office.

Another method is to paste these data in scrap books (simply pasting at extreme top edge to hold in place) indicating book and page number on the customer's credit card, as shown in Figure 26.

This form is filed and kept permanently in the general credit file, in alphabetical order, for the entire business. This

card is made of thin stock and when written up by a branch office, a carbon copy is made, one for the general credit department file, and the other for the branch office file.

NEW ACCOUNT

Account Folio	Date
....	....

Name ....
Residence ....
....
Limit $..
Reference card inclosed with reports from the following firms:
....
....
....
Letters inclosed from ....
....
....
Agency Reports
Red Book 192..

Figure 25. Pocket Envelope Form

NAME	NEW ....REVISED.....DATE.....
ADDRESS	CR. LT. $........TERMS
....	GASOLINE ....
BUSINESS	FILE BOOK NO.....PAGE NO.....
	RTGS.—DUN.......BRAD........

Figure 26. Customer's Credit Card

In a large business it is necessary to notify other departments of credit limits and terms. For this purpose a form like that shown in Figure 27 is used.

This form is printed on very thin stock (tissue) and is prepared to register lines with the credit card shown in Figure 26 above, to permit the preparation of these records at one operation on a typewriter. Copies of this notice are then sent to as many departments as are interested in the customer, in that way making a complete file of customers in whom the particular branch, warehouse, department, or retail store is interested.

NAME	NEW ....REVISED.....DATE.....
ADDRESS	CR. LT. $.......TERMS.........
....	GASOLINE ....
BUSINESS	FILE BOOK NO.....PAGE NO.

................DIST. OFFICE

BOOKKEEPING DEPT.

CREDIT DEPT.

WAREHOUSE

RETAIL STORES

1	2	3	4	5
6	7	8	9	10

After investigating the credit standing of the above customer, we have placed credit limit and extended terms as indicated.

If, at any time, you find this customer desires a larger line of credit, we will be pleased to have you advise us, furnishing us with any new information regarding their financial responsibility that you have secured.

We will then be in a position to gladly review the case.

....

CREDIT MANAGER

Figure 27. Inter-Department Notification Form

There are doubtless many more complicated and expensive credit filing systems. The above is the outgrowth of investigations of many different methods and forms, and is perhaps one of the simplest, most efficient and least expensive systems in use, especially under the varied conditions under which it has proved successful.

Relation to Sales Department.—A stock question has gone the rounds at credit conferences and conventions for a num-

ber of years as to which is the most important department of a business, usually using the Sales and Credit Departments for comparison. Many deceive themselves into thinking that one department or another is the more important. That is a mistaken idea. Each department of a business has its particular functions to perform. These functions are of equal necessity and of equal importance, a *means* to an end, in the conduct of any successful organization. When it comes to organizations, no man, or group of men, or state, or nation dare claim to be more important than another in the conduct of the affairs of any organization. Whatever part of an organization makes such a claim is immediately inviting trouble, stirs up controversy, and repels that fine spirit of cooperation which is necessary in organized effort.

Keeping the Credit Department Independent.—A question of very great importance, however, concerning the Sales and Credit Departments, is this: Should the Credit Department be made a part of, or subordinate to, the Sales Department, or should it come under the financial department. As credit is a temporary substitute for money in commercial transactions, the extension of credit is certainly a function of financing and not of selling.

Unless a sales manager, or a Sales Department, is qualified to handle successfully the finances of a business, the only possible excuse for subordinating the Credit Department to the Sales Department, is *expediency in selling*. And a policy of mere expediency in selling, if the sales manager, or Sales Department, is not trained in extending credit and in financing, is very apt to lead to bankruptcy. This is true because the salesman and sales manager are naturally, by virtue of their position, placed in a biased position as to credits, unless they have a financial interest in the business that would cause a personal loss in keeping with the loss sustained by the business

itself. The sales manager is interested in selling, and when he is met by keen competition in prices and other factors, when he is being pressed to increase his volume of sales, when his salary and commissions are at stake, he is placed in a position where to put the facility of credit granting into his hands is not fair to himself or those whose investments are at stake in the improper use of credit.

Beyond this one point, however, of being placed in an unbiased position to render credit decisions in doubtful cases, the credit department should at all times be ready and willing to meet the reasonable demands of the sales department in every way possible.

The credit department is too frequently looked upon as merely a "watchdog." It is of necessity that, but it should not merely be that alone. It should also be a constructive force. It can be of considerable assistance in increasing the company's sales, if the affairs of the department are properly conducted. We will admit that the first duty of the credit department, in collection work for instance, is to secure the money, but a very close second duty is to retain the friendship of a customer and thereby help build for the future. An order from a new customer should not be viewed with an eye single to that particular order, but that order should be looked upon as merely an entering wedge for a future profitable business. Therefore, every letter written and every move made by the credit department should be done in a way that will reflect genuine service and interest.

Relation to Accounting Department.—The accounting work of a business is so closely linked with the credit department that the dividing line in the work is sometimes hard to define clearly. Wherever the dividing line between these departments is drawn, which after all is largely governed by the nature of the business and the policy of its management, the

closest kind of cooperation is necessary, as well as a strict policy of keeping up to date the accounting records of the customers' dealing with the house.

The credit department is confronted with many difficulties in a careless or inefficient accounting department. One serious element of injustice in the situation is that when the damage has been done and brought to the attention of the business management, the real cause of the damage has in the meantime been caught up or corrected in the accounting department, and the reflection often rests upon the credit department. It is no doubt true that memory plays a very great part in credit work, but where there are many thousands of accounts to be handled, it is necessary to have a system that will automatically keep the credit man posted on the status of the various accounts as a whole and particularly on the questionable ones, of which there are always a number.

Keeping Track of the Accounts.—A matter to be closely watched is the shipments made to a customer between the time they are passed by the credit department and the date they are posted to the ledger account, particularly when the bookkeeping department has the habit of falling behind in its work, as is often the case. This last statement may sound a little strange, and according to theory is not correct, but the fact remains that in actual practice it is frequently true, and is a contingency that must be met and cared for by the credit department if it is to survive in a big business. There must be some means, other than memory, to take care of this feature of the work.

A system requiring posting clerks, working on ledger accounts, to notify the credit and collection departments of overdue accounts, is sometimes a good one, if it works. But when bookkeepers are frequently behind in their work, such a system is most inadequate. A credit manager depending

on such a system is pretty sure, before long, to find his accounts in a hopeless state. Under such conditions, and they frequently exist in practice, it is necessary to have some method of keeping in touch with all accounts, and at the same time if possible prevent the cost of practically keeping a duplicate customer's account in the credit department, which is also frequently done.

A practical, inexpensive method is as follows: Every concern must bill its customer for goods shipped, or at least have delivery or sales slips, and many issue monthly statements of customers' accounts. Having these bills, or slips, or statements, made up with an extra carbon copy for the credit department, will automatically and continuously keep that department informed on the activities of accounts regardless of when the bookkeepers catch up with their work. So much for charges. If a carbon copy of the daily deposit sheet is furnished the credit department, listing on the copy retained by the house (which can also be used as a posting medium by the bookkeepers), the names of customers opposite amounts shown, the credit department can check off or discard copies of paid bills. Such a plan or system enables the credit department to be always up to date, eliminating a great deal of needless friction, dissatisfaction, and loss, and at the same time furnishing a double check on every order that is passed, and providing a maximum safeguard on ledger accounts and order checking.

Orders, Shipping and Transportation.—The order, shipping and transportation departments should not be overlooked when credits and collections are in process. These departments are frequently in a position to give very material assistance to the credit manager, and vice versa. Prices, packages, rolling equipment on large orders, etc., are all factors that can often be made to work for or against the credit department. Close cooperation and the manifestation of a friendly

spirit between these departments can often work wonders in handling a difficult situation. By stretching a point the credit department can sometimes materially assist in helping move a surplus stock at a time when prices, shipping facilities, etc., are favorable. This service can be reciprocated by the other departments sometimes putting the brakes on prices, or orders, or shipments, while the credit department is getting some overdue money, or by the transportation department putting a little exra effort in catching a car enroute to a customer whose promise has not been kept.

Inter-Departmental Communication.—In order to have the best coordination of effort between all departments of a business organization there must be a constant line of communication between departments on transactions where two or more departments are concerned. This may be done in person, by telephone, or by the use of letters and forms. As a matter of record, it is often advisable to have these communications in writing, and therefore, as a matter of simplifying the work and keeping costs down, various printed forms are usually found to be the most efficient and inexpensive means of contacting with other departments on details. Some of these forms are shown in another chapter in connection with actual procedure.

References

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CHAPTER XVI

CREDIT DEPARTMENT PROCEDURE

Outline of a Typical Case.—Perhaps the best way to describe the procedure of work in a credit department is to take a hypothetical problem and follow it through the department to show the methods employed, the equipment and system used, and the department's contact with other departments. The scope and purpose of this book would not permit going into the many different types of cases that come to a credit department for solution. So we shall try to make this imaginary case cover as many points to be encountered in an ordinary day's work as possible. The deductions, however, are not intended to be exhaustive, nor are they applicable to every case. Forms and details differ in various lines of business, according to usage and custom. Equipment and system also vary greatly in different kinds of business, as to size, type, location, business policies, etc. A large house selling quantities of small articles to thousands of jobbers and retailers will employ methods quite different from those of a house selling some large equipment to a select trade. But, whether it be a large business employing a number of employees in the credit department, or whether it be a small business with a one-man department, the same principles and similar routine methods apply.

Routine of an Order.—The following chart (Figure 28) will perhaps help us to visualize the routine of an order from the time it is received until the money for it is collected or the account is charged into profit and loss account:

As a departmental background for our illustration we shall take the credit department charted in Chapter XV, Figure 23.

Among other orders sent by salesmen is an order for one carload of material from the Evans Packing Company, Inc.,

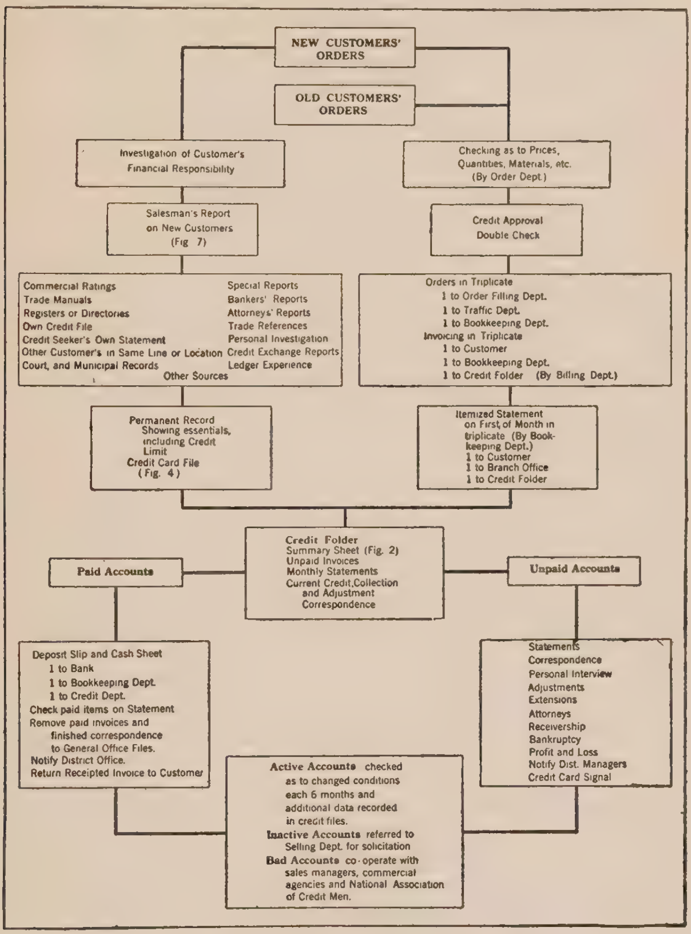

Figure 28. Routine of an Order

manufacturers of metallic and fibrous packing boxes. With the order is a "Salesman's Report on New Customer," similar to the one shown in Figure 29, on which he gives name and

address, kind of business, three trade references, (The Smith Supply Company, St. Louis; Blank Coal Company; and Good Machinery Company) the customer's bank (The Sixth Street National), the approximate amount of the first order ($500.00), and estimated requirements as two cars per month, or $1,000, terms sold 1% cash 10 days, 30 days net.

SALESMAN'S REPORT
ON NEW CUSTOMERS

NAME ....
STREET ADDRESS...
P. O. ADDRESS...
STATE ....

If other than an individual, give names of partners, officers or proprietor ....
....
....

Business or occupation...................................
Experienced or just beginning...........................
Your impression of his business.........................
Stock, large or small.....................................
Stock, good or bad condition.............................
Real Estate Owned..
Good or bad condition.....................................
Has been buying from.....................................
....
....
....
....
Banks with..
....
....
Approximate amount of first order $......................
Estimated requirements: $................................

SALESMAN ....
Date ....19....

Figure 29. Report on New Customers

From the executive offices, where all mail is opened, come letters, mercantile reports, checks, notes, trade acceptances, salesman's reports, legal documents, copies of orders shipped from warehouses, branch office reports on credit matters, etc.

REMITTANCE MEMO.

NAME ....

ADDRESS ....

LEDGER FOLIO...

Cash				
Total				
Deduct				
Dict				
Total Cr.				

REMARKS

Figure 30. Remittance Memorandum

These all go to the desk of the assistant as shown in Chapter XV to be stamped with a receiving stamp, and all mail, except checks, after stamping is placed on the credit manager's desk. The assistant takes the envelope in which the check is received,

usually bearing the name and address of the remitter, and places on it the amount of the check, together with any other information on the check of assistance to the bookkeeper; if it is a voucher check, the voucher, if permissible, is detached, and placed with envelopes; if an invoice or statement accompanies a check, that is placed with envelopes and vouchers; if nothing accompanies check, a form like Figure 30 shown below is filled in and placed with the other papers.

If any apparent irregularity appears in a check, the questionable check is referred to the credit manager for action. After proper note of every check has thus been made, the amount of the checks is run up on an adding machine, and then the amounts of the memoranda are added. The two totals must agree. The checks are turned over to the assistant's stenographer who immediately sorts them as to districts, sending each district manager a list of checks received from customers in his district. The checks are then turned over to the treasurer's office, where the cash sheet and deposit, together with an extra copy for the bookkeeping department, are typed at one operation. In the meantime the cash memoranda above referred to have been turned over to the bookkeeping department where the remittances are immediately "keyed in" opposite the invoices paid by showing the date. No posting is done at the time; in fact the posting can sometimes be many days behind; but collectors and credit checkers immediately know of the remittance even though the balance shown on the account has been reduced, and is therefore incorrect. In this "keying in" process the bookkeeper often discovers improper deductions in payment. He immediately notifies the credit department adjuster, who takes whatever action is required.

When an adjustment of any kind is necessary in the account, the form shown in Figure 31 is prepared in triplicate. (These forms are printed in three colors, each color indicating the department to which it belongs). One copy is kept by the

credit department to show that an adjustment is in process, and two copies are sent to the accounting department adjuster for sanction of adjustment of the records. After the adjustment or allowance is made or sanctioned, one copy is sent to

CUSTOMER'S CLAIM

Number..............

Attention Mr.

NAME.......................... ADDRESS..........................

DATE INVOICE.................. AMOUNT OF CLAIM..............

REASONS ....

CORRESPONDENCE ATTACHED (YES) (NO). (SIGNED)..............

CREDIT AUTHORIZATION

MR.............................. DATE......................

You are authorized to issue Credit Memorandum for the amount of $......................

(Signed)............................

Credit Memorandum has this day been issued in accordance with authorization.

Number................ Amount $.................

(Signed)............................

Correspondence and copy of Credit Memorandum relating to this adjustment to be filed together.

Figure 31. Form of Customer's Claim

the bookkeeper to adjust customer's account, and notice of adjustment sent to the credit department on the form shown in Figure 32.

Securing the Credit Information.—Let us now return to the credit manager's desk, where was placed the morning's mail, and the particular order of which we received notice from

the salesman. On the back of the desk are letter trays on which may be found the names of the credit manager's assistants, adjuster, secretary, various clerks; one for the filing clerk calling for previous correspondence; one for "letters to be signed," one for "outgoing mail," and another for "finished work-file." He places in the tray of the assistant in

TRIPLICATE

Number............

ADJUSTER'S REPORT—CUSTOMER'S CLAIM

ATTENTION MR......................

MR......................

NAME.......................... ADDRESS......................

DATE OF INVOICE.................. AMOUNT OF CLAIM...........

DISPOSITION ....

....

Signed......................

DATE........................

Figure 32. Form of Adjuster's Report

charge of credit limits the salesman's reports on new customers, reference letters, mercantile reports, and matters bearing on his work as indicated by Figure 23 in Chapter XV. The various persons concerned watch these trays and empty them at regular intervals. The assistant finds the salesman's report on the Evans Packing Company, Inc. He turns it and other similar slips over to a clerk under his jurisdiction to look

up rating in Dun's and Bradstreet's rating books. (These books, with other rating books are kept ready for consulting on a table in a convenient place in the credit department, which saves time in handling.) He finds no rating in Dun, and a rating of "Q B" in Bradstreet ($50,000 to $75,000—1st Grade) and so marks the slip. After finishing other slips of the same kind, he returns to his desk and writes out a ticket requesting a special agency report, where necessary, including the Evans Packing Company, Inc. The request to the agency reads as indicated in Figure 10. As the Evans Packing Company's order, and several others, are rush orders, he calls Bradstreet's on the telephone and finds they have special reports on file. He immediately sends a messenger to the local office and secures the special reports requested and returns to his desk. He sees from the salesman's slip that two of the customer's references are located in the same city, so he telephones the credit departments of these concerns (the credit manager having established reciprocal relations with responsible local business houses through the Credit Men's Association) and finds that one house is selling as high as $500.00 monthly and the other $1,000.00, on thirty day terms, and that bills are promptly paid, owing in the first case $250.00 and in the second $750.00, none of which is due. He calls up the bank and finds "they have been carrying a satisfactory account with it for a number of years, and believed to be worthy of confidence." He then takes a form and summarizes the information he has gathered.

Making the Decision.—This form with detailed data attached is handed back to the assistant credit man to pass upon and fix a credit limit, which he does in all cases up to $1,000.00, or some other designated limit, leaving the more important cases for final decision by the credit manager.

The credit man at this point must exercise keen judgment,

weighing the favorable and the unfavorable factcrs. After his analysis of a risk, he attempts to forecast what the person or persons concerned are going to do at some future time. He renders his decision, fixes credit limits and terms, and then and there assumes the responsibility of collecting the account to the extent of his credit limit. In this function he renders one of the most important services that can be rendered in a business enterprise, and one upon which often hinges the success or failure of a business. All this requires organization and system to handle successfully, and in volume. Such a system and organization must all along the line provide automatic danger signals to the credit man. In other words, a correctly organized and systematized department makes it possible for any member of the department, of good intelligence, to handle routine matters, and at the same time makes it impossible for a single order to be passed or shipped to a customer whose credit standing does not justify it. That is the kind of organization needed to relieve a credit manager of routine work and place him in a position where he is free to give the larger aspects of his work adequate attention and constructive consideration.

In Figure 28 are given a number of sources of credit information. Only as many sources should be consulted as are necessary to secure sufficient data on a given case along the lines described. In consulting some of these sources, certain accepted forms are used, of which several of the most frequently used have been shown.

After a risk has been approved, credit limit fixed, and various departments and branches notified, the next step is to have this data filed in readily accessible form, the system for which has been covered in Chapter XV.

The credit limits are always subject to revision on learning new facts. The placing of limits merely serves as a guide, and is a restriction beyond which assistants must not pass without

the approval of the credit manager. Credit information should be kept alive by revisions and additions as facts are gathered. Credit files should be reviewed and brought up to date once or twice annually. With such a system, the question of passing orders becomes a matter of routine and can be successfully handled by assistants, except in questionable cases.

Cooperating with the Order Department.—While the foregoing work is being done by the credit department, the order department (see Figure 28) has checked orders as to prices, quantities, materials, etc., and has prepared filling orders on the company's form in triplicate, one copy for the order filling or shipping department, one for the bookkeeping department and one for the traffic department. All these are sent to the credit department for approval or rejection. The Evans Packing Company's order is among these orders, and, when the assistant who attends to this work (see Figure 23) receives this the credit investigation has sufficienty progressed to permit the approval of this order. After approval one copy of the orders is sent to each of the departments above indicated.

But among the orders may be some that cannot be approved. These are referred to the credit manager for attention. When an order is held up, because credit limit has been reached, because the account shows overdue payments, or for any other reason, the selling and order departments should be immediately notified. By doing this the selling department can cooperate with the credit department in bringing about conditions that will make possible the approval and shipment of the order, and the order department has an opportunity to make necessary adjustment in its schedule of shipments for the shipping or manufacturing departments. The form shown in Figure 33 below is used in notifying these departments of orders held.

These orders are placed in a separate file and a weekly report is made to the credit manager showing a list of such

orders, the reasons, and the progress being made toward approval or final rejection. After matters have been adjusted

Date..............................

SALES DEPT. OR DISTRICT OFFICE:

ATTENTION: MR..................................

ORDER No......................... received by the Credit Department this date from...................................for ....is being held for the following reason ....

As soon as this has been adjusted you will be notified.

CREDIT DEPARTMENT

Per..................................

Our reason given above is strictly confidential and is for your information only.

Figure 33. Notification of Order Held

Date..................................

SALES DEPT. OR DISTRICT OFFICE:

ATTENTION: MR......................... ......

ORDER No.........................held by Credit Department on............................ given us by.............................is being (released) (rejected) today. If rejected, reason therefor........................

CREDIT DEPARTMENT

Per...............................

Our reason given above is strictly confidential and is for your information only.

Figure 34. Notification of Order Released or Rejected

to permit passing such orders, the selling and order departments should again be notified that they may be informed of action taken. For this purpose, form shown in Figure 34 is used.

It will be observed that this system provides a means of placing at the disposal of everyone whose duty it may be to approve orders, all the information available on a customer. If the credit man obtains information and impressions by way of personal interviews, telephone conversations, conferences with other credit men, etc., a record should be made so that others may have the benefit of this knowledge when called upon in his absence to deal with a customer. It is often necessary for a credit manager to be away from the office. By making a memorandum of such information and impressions and passing it to a typist, it can very readily be made a part of the customer's record in the credit file and thus prevent mistakes. A credit department organization and system should be efficient enough to permit the credit manager to leave the office at any time and still adequately take care of anything that may come up in the ordinary routine of business.

Miscellaneous Duties of the Credit Manager.—On this subject of procedure, let us take another look at the credit manager's desk. Let us assume that he has distributed all routine matters to his assistants and clerks; he will still have a number of things requiring his personal attention that will keep his time quite well occupied. Among such items will be found protested and improperly drawn checks, notes to be accepted or rejected, requests for special terms and extensions on accounts, stubborn cases where credit information is not readily available, revision of terms and credit limits to old customers, personal interviews, attending creditors' meetings and assisting in prosecuting fraudulent cases, attending trade group meetings, giving personal assistance to customers in difficulty, attending credit men's meetings, travelling over his territory or visiting branch offices, directing collection of troublesome accounts, making adjustments of stubborn cases, rendering reports to, and conferring with, officers of his com-

pany, cooperating with sales department on new business and increasing lines to old customers, keeping abreast of the times through reports, statistics, journals, periodicals, etc., on all matters of general interest bearing on credit and economic conditions, beside answering the many questions of departmental employees that come up in the ordinary routine. A credit man, if he puts his heart into his work and properly equips himself and his department, can make himself one of the most valuable men in an organization.

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CHAPTER XVII

ANALYZING THE RESULTS OF CREDIT DEPARTMENT MANAGEMENT

Factors in Credit Department Efficiency.—A credit department may rightfully be considered an asset to any business house doing a credit business, if its acceptance of good business approaches the possible maximum amount of bona fide business secured by salesmen, with a small loss in bad debts; if it causes a minimum loss of customers in handling the accounts; and if it operates at a low rate of expense to the business.

A credit department should be considered a liability, if: it fails to accept the proper amount of business safely possible to accept; if it has an excessive bad debt loss; or causes the loss of customers through improper methods; or if it operates at too great a cost to the business.

Briefly stated, those are the determining factors of whether a credit department is an asset or a liability to any business. But this naturally raises some interesting questions, namely:

1. What constitutes the maximum amount of business that shall be accepted?
2. What is the minimum, or proper, bad debt loss?
3. What is a minimum loss of customers by the credit department?
4. What should it cost to operate a credit department?

Maximum Amount of Business to be Accepted.—In any line of endeavor there is a potential field or market, developed or capable of being developed, for that particular commodity or service. That field or market constitutes a potential unit of 100. If there are ten competitors doing business in that

field or market, all being on an equal basis as to facilities, service, qualities, prices, etc., theoretically there would be as each competitor's share, a unit of 10. But there are set to work on that potential unit of 100, ten competitive sales organizations, each being keyed to the highest pitch of enthusiasm and inspiration (often with bonuses and commissions as an incentive) to secure the greatest possible amount of this 100 unit.

In this 100 unit, though, there are all kinds and grades of credit risks. Some of these will actually fail; (according to Bradstreet's figures in 1923, 33.7 per cent will fail from incompetence, 34.2 from lack of capital, 4.2 from fraud, and 27.09 from other causes). Some will require litigation to collect. Some will be extremely slow pay and therefore unprofitable. Some will be fair to good risks in the making. Some will be fair pay. Some will be good pay. Some will be discounters.

It naturally follows then, that as prices, quality, service, salesmanship or other purchase inducements to the customer, fail to measure up to the standard of competitors' inducements, the lower will become the grade of credit risks of the customers sold, in order for that house to secure its share of the 100 unit. When purchase inducements to the customers are on a par with, or superior to, those of a competitor's inducements, it is easiest to sell to high grade credit risks with correspondingly lowered credit department expense. When purchase inducements to the customer do not compare favorably with those of competitors, only the poorer grade credit risks can usually be sold, and that immediately throws a greater burden and responsibility upon the credit department.

As a general proposition it is usually estimated that at least ninety per cent of the business submitted for credit approval is of good or fair grade risks and that not over ten per cent of it should be of a class that requires treatment outside of the routine of a well organized and properly func-

tioning credit department. In this ten per cent will usually be found, in ratios varying with different houses, about all of the off-grades above mentioned. As purchase inducements to the customer, compared with competitors' inducements, become less favorable this 90/10 ratio will usually tend to go down, sometimes until a 50/50 ratio is reached. When this latter ratio is reached, or anything approaching it, it is safe to say that a pretty efficient credit department is required to keep the business out of bankruptcy.

Therefore, a credit department that accepts risks submitted on a grade ratio of 90/10 or downward (as above described) rejecting or selling for cash only the worst grades may be said to be accepting the maximum amount of business for its house.

Minimum or Proper Bad Debt Loss.—What is a minimum, or proper, bad debt loss is a much mooted question. Credit men, as a rule, are very vague and evasive when this question is discussed. The fact remains, however, that in 1923 there were 19,159 failures with liabilities aggregating, according to Bradstreet, $631,794.00, not to make mention of the many thousands of bad accounts that were at least indirectly responsible for many of those failures, which were never collected. Then when there is added to that sum the "bad" accounts which were charged off in 1923 by approximately 2,055,458 business houses that did *not* fail, there is a bad debt bill, to be ultimately paid by the consumers of this country, that almost staggers the imagination. If it were possible to obtain these figures and ascertain the average per cent loss to sales, we could arrive at a standard by which we might measure this phase of credit work.

Perhaps the nearest approach to a correct per cent loss in any case, is to take what is found to be the average loss by a number of houses in the same line over a period of three or five years. This should be accepted as a correct experience

and be used as a basis for consideration of bad debts in price computation. If this average were, let us say, 1%, and a credit department did not exceed this average, and accepted business as above outlined, it could well be said to have sustained the minimum loss in its transactions.

Measuring the Importance of Lost Customers.—Let us assume that a credit department accepts business on a grade ratio of 90/10, if it loses, through its efforts to collect (when customers have been properly sold and service and material are satisfactory) and of the 90% fair or good grade risks, it is certainly losing good material. If, however, a customer among the other 10%, above described, is lost for future business, in securing the money for the first transaction, or if the customer refuses to accept terms satisfactory to the seller, then it is hardly fair to charge the credit department with having lost a customer. It merely failed to make a fair or good customer out of a doubtful, poor, or bad one. If, on the other hand, the credit department helps to make fair or good customers out of say 5% or more of whatever percentage of the doubtful class have been accepted, it certainly becomes a greater asset to the business as this percentage of doubtful risks, remade into fair and good customers, increases. Let us say that a credit department accepts business on a grade ratio of 50/50, saves as good business for the house 25% and fails on the other 25%, that credit department should be credited with having saved and built for the business 25% of its customers, and not with having lost 25% of them. A credit department should be charged with losing a customer only when it is the *avoidable* cause of losing a fair or good paying customer.

Measuring the Cost of Operating a Credit Department.—The cost of conducting a credit department is of course

largely predicated upon the kind and nature of the business conducted. Much depends also, as above intimated, upon the class of business the department is called upon to accept and handle, because it stands to reason that if a large volume of poor grade credit risks is taken, the cost of operations will be much greater than where only select trade is accepted. It naturally follows that costs of operation should be greatly increased if the credit department is making business possible with a poor credit class of trade which is made necessary by some weakness in other factors of the business. In that case the credit department is made to carry part of the burden rightly belonging to some other department or departments, and should, therefore, not be expected to operate as cheaply as when that is not true.

For the purpose of illustration then, we may safely assume as a reasonably low cost of operation, 1% of sales when business of a grade ratio of 90/10 is being accepted and profitably handled. Why the assumption of 1% as being a reasonably low cost of operation?

Underwriters of insurance on credits charge a special premium for, place rigid restrictions about or penalties upon, or decline to assume liabilities in connection with any situation which they designate as the off-grades, above referred to, under their insurance policies. That is just as correct and proper as it is to charge an extra premium or provide special safeguards, or refuse to accept responsibility for, an extra hazard under a fire, or any other form, insurance policy.

Moreover, these underwriters cover, under the ordinary bond, only losses *over and above* the normal loss of that particular business, determined by an average loss for a period of three or five years. The bond also usually provides that the company be given an opportunity to collect the losses, and that losses be reported for collection purposes within sixty-five days from due date, for which approximately the legal col-

lection rates are charged in addition to the premium. The legal rates for collecting are 15% for amounts under $300.00, 8% for amounts between $300.00 and $1,000.00, and 4% for amounts in excess of $1,000.00, making the average legal rate 9% (not taking into account apportionment of percentages by amounts of losses). That places a pretty high premium on time in credit granting.

The management of various lines of business place a still greater premium on time when they offer ½, 1, 2, 3, 5 and in extreme cases 10% for cash within, usually, 10 days from date of shipment, paying actually at these rates for 10 days' time from 18% to 360% per annum.

Is it not true, then, that 1% of sales is a reasonably low cost for operating an efficient credit department in the average manufacturing, jobbing or wholesale business, to collect the bulk of moneys on sales in the intervening period of from 10 to 60 days? Is it not a cheap collection rate? The percentage on a retail business will run higher.

Application of this Principle of Management.—Taking the above assumption as approximately correct as a general average proposition, let us see what we actually arrive at for a $25,000,000.00 per year business:

Method of Figuring Collection Costs	Comparative Costs by Methods
Cost, figured on collections by credit department on basis of 1% of sales on 90/10 grade ratio........................	$250,000.00
Cost, figured on collections on basis of accepting only customers discounting, on terms of 1% cash 10 days=36% per annum on monthly sales ($2,083,333.34)........................	750,000.00
(This would probably prohibit 75% or more of the business on an average concern's books.)	
Cost of collections on lowest legal rates (4%)..............	1,000,000.00
(At least this rate would apply if no effort were made to collect at all in first 60 days on 30 day terms, accepting any and all business submitted, plus a probably ruinous loss ratio for bad debts.)	

By the first method (with a loss on account of bad debts of 1%), the total cost would be 2% of sales for credit operations and bad debts.

Under the second method there would still be the hazard of the average loss by actual failures, which, according to Bradstreet (by percentage of failures to all in business failing), from 1893 to 1923 inclusive, averages 1.01% per year. It is quite probable by this rigid selection of accounts that the loss ratio would be practically nil, yet the cost of operations would be 3% of the annual business, plus greatly increased sales expenses as well as other expenses and the necessity of having an article or service that could stand severe competition. And there still would have to be a credit department to do the selecting.

Under the third method there would have to be a sales force to sell, and some one to look after what collections were made, and the cost of operations would still be at least 4%, with an extremely high ratio of losses in addition.

The foregoing forms a basis upon which to determine the worth of a credit department. And while the general figures (used only for illustration) show an advantage of 3 to 1 and 4 to 1, respectively, in favor of the conservatively conducted credit department, that advantage may be increased as cost and loss percentages are decreased, and the 90/10 grade ratio is lowered to take in a greater percentage of bona fide business on terms that are safe. To lower the grade ratio is largely a matter of having customers of doubtful grades accept satisfactory terms and then seeing to it that those terms are as nearly as possible enforced. In this connection the question of minimum loss of customers applies with particular force.

It is possible under proper management to obtain much better results than the general and average figures and percentages above shown. This has been proved. An actual experience may perhaps with profit be cited, where the bad

debt losses were about 3/10 of 1%, and the cost of operations about 4/10 of 1% on a risk grade ratio of better than 75/25; with few, if any, good or fair paying customers lost by improper methods of the department, and a high percentage of sales on poor credit risks developed into good ones.

The total combined cost of operation and bad debt losses amounted only to 7/10 of 1%, while it is stated that the sales price of the commodity of that particular house had been loaded by 2% for bad debts, having an actual profit of 1 and 3/10% to the house on that feature of the business.

Business Failures and the Responsibility of the Credit Department.—When a business fails the credit manager is always present because it is he who has extended credit and who is now interested in salvaging the remaining assets. If he is a good credit manager he learns much from each of these unpleasant experiences. He feels his responsibility, not only for his house, but also for the credit structure of the business community. He realizes that credit is a valuable economic factor only to the extent that such transactions as are originally stimulated are ultimately consummated.

The reasons why businesses fail and succeed are difficult to classify, because of the varied types of influences which affect men in the processes necessary to satisfy human wants. The credit manager will develop for his own use various methods of arrangement for his own study and protection adapted to the line of business in which he is engaged. As a starting point in the analyses we suggest that the credit manager study all of the failures with which he comes in contact, arranging the causes under the following three divisions:

1. Causes of business failures over which he has no control.
2. Causes of business failures over which he has a limited control.

3. Causes of business failures for which he is primarily responsible.

It is of course understood that it is many times impossible to adopt a dogmatic classification. The plan is valuable nevertheless and stimulates productive thought. In some situations, certain causes can be put into another group. The efficacy of analysis of this type in teaching the credit manager to assume his position of responsibility is evident.

In the group we find a large number of physical causes such as war, floods, tornadoes, earthquakes, crop failures, epidemics, erratic climatic conditions, etc. Other causes over which the credit manager would have little, if any, influence are: Changes in public demand, a cause operating in certain markets (one of the best examples being the bicycle industry), new inventions as indicated by the change from buggies to automobiles, greatly increased competitive pressure, unsound national monetary policy, changes in relationship to foreign markets, failures of others, general unemployment in the territory served, with attendant decreased buying power, and sickness or death of executives.

In this group would be listed those causes mentioned in the first group which might have been prevented or their effects ameliorated by the foresight of the credit manager. In a limited way he is responsible for the business methods of the firm to which he extends credit; for ascertaining the character and reputation of his customers; for an estimate of their competency, experience, and organization ability; and for analysis of financial structure in relation to capitalization. He is to a certain extent held responsible for the adoption of good business practice in connection with the points mentioned.

At one point the credit manager can be held absolutely responsible. If he extends credit knowing that it is unjustified on all the bases as he understands them, he has no one to blame

but himself when failure occurs. A house in which sales policy dominates too strongly often finds itself in this situation. In this group of causes should also be those included in the other two groups as to which particular situations have given opportunity for the use of the credit management influence. He must accept responsibility for all failures where he might have given his advice in the creation of sound policy. His house is in partnership with the creditor and he is to that extent entitled to the privilege of making suggestions and liable for negligence if he refuses to do so.

The credit department referred to on page 232 had also rejected 3/10 of 1% of sales on credit, which it failed to switch to cash terms, that subsequently were shown to be "bad" accounts, and if accepted would have been losses, making a further 3/10 of 1% of sales actual worth evaluation on that credit department. On this latter feature the sales manager argued, it is stated, that had this "bad" 3/10 of 1% been accepted, with no credit department expense, the loss to the house would have been 1/10 of 1% less than it was. The trouble with his argument was that he forgot that more than 25% of doubtful credit grade business had been accepted from his salesmen, and profitably handled by the credit department for the house. Like the child in the anecdote, he expected to have the cake and keep the penny.

References

No readings are suggested on this subject. The student ought to make an application of the principles just presented and analyze in detail the efficiency of some credit department.

CHAPTER XVIII

RELATION OF CREDIT MANAGEMENT TO THE GENERAL MANAGEMENT

The Part of the Credit Manager in Formulating Policies.—In preceding chapters there have been discussed in one form or another the credit manager's relations with the customer, with other departments of his own house, with outside agencies, and with credit men of other organizations. Those are four relationships which the credit manager should constantly nurture, must, as far as possible, constantly keep warm and friendly, so that all may be mutually benefited and served. These four relationships for the credit manager, so far as his immediate position is concerned, are only the *means* to the *end* sought. The end *he* seeks is to please and serve his superior officers who constitute the general management of his house. How may he best do this?

In Chapter XV mention is made of many of the credit manager's functions and activities, and the statement is made that he is expected to accept for his house a maximum amount of business with a minimum amount in bad debt losses, with a minimum loss of customers in making collections, and at a minimum expense to the business. Briefly stated, that is his problem so far as his relation with the general management is concerned.

To accept a minimum amount of business that can be collected promptly requires all the facilities and ability that the average credit manager has at his command. Much depends upon the type of salesmen employed and the kind of trade to which the house sells, but as a general proposition it is usually estimated that 90 per cent of business submitted is

of good or fair grade of risks, and that not over 10 per cent of it should be such as requires anything but the standard routine service of the department. In this latter grade of business is the opportunity for the credit manager to exercise the prerogatives of his department in such a manner as to lose business that is potentially good, or to accept this business and help re-make it into a good grade of risk and thereby increase the amount of business that can be accepted. To do the latter, beyond the usual functions of routine credit granting, resolves itself to a great extent into policies of management. Policies of management are sometimes dictated more by force of circumstances than by a mere matter of choice, but regardless of the impelling motives, the credit manager should have a voice in forming policies to insure the efficacious enforcement of them.

Enforcement of Terms.—One of the policies of management that usually concerns everyone to a transaction is that regarding enforcement of terms. Shall terms of sale always be rigidly enforced regardless of consequences, or shall there be an application of common sense in considering some of the things that often greatly affect terms of sale? There are many things that may enter into the consideration of this policy. The following are some of them:

Kind and nature of the business.
Quality of merchandise or service as compared with that of competitors.
Prices as compared with those of competitors.
Distance, affecting time of delivery and transportation charges.
Seasons.
Markets.
Advertising policy, affecting sales resistance and creating demand.
Class of salesmen employed.
Grade of customers solicited.

Discounts, trade and cash.
Perishability of products.
By-products and their possible market.
Distributing agencies.
Dispensing equipment.
Storage facilities and containers.
Desirability of buyers' location for trade.
Adjustments.
Desire for expansion in new and old fields.
Investment considerations in expansion plans, etc.

All these are things that vitally affect the acceptance of risks, and consequently the maximum volume of business that can be accepted. They have a bearing on the amount of bad debt losses, the loss of customers, and the expense of conducting the credit and collection department.

Accounts Receivable, Current	$........
Accounts Receivable, 30 days overdue..................	....
Accounts Receivable, 60 days overdue or more (not including attorney and uncollectible accounts)	....
Accounts Receivable, In attorney's hands................	....
Acccounts Receivable, Uncollectible	....
Accounts Receivable, TOTAL	....
Collections	
Net Sales	
Value of orders held up	
Value of orders canceled	

Figure 35. Monthly Report from Branch Office

But, whatever the question in point, or the policy involved, the general management of a business should always be accessible to and approachable by the credit manager. Unless this is made possible the best coordination of departmental activities cannot be had. There should be frequent conferences between the management and the credit manager.

A Report System.—There should be an adequate system of reports from branch offices to the credit manager, and from the credit manager to the general management. A form like that shown in Figure 35 should come regularly from all branches to the credit manager. These should be assembled for the management on a summary form like shown in Figure 36. Results from this form may then be graphed as to sales, collections, and receivables, as shown in Figure 37.

When the above reports are received, tabulated and graphed, it is no difficult matter for the management to place their hands

BRANCH ACCOUNTS FOR......1923

Branch	Current	30 Days	60 Days and Over	Attorney	Uncollectible	Total Accounts Receivable	Collections	Sales	Orders Held	Orders Canceled
....	....	....	....	....	....	....	....	....	....	....
....	....	....	....	....	....	....	....	....	....	....
....	....	....	....	....	....	....	....	....	....	....
Totals	$......	....	....	....	....	....	....	....	......	....

Figure 36. Monthly Summary Form for Assembling Branch Office Reports

on any phase or branch of the work that is not showing proper ratios and percentages. These reports show the management the amount of sales being made, amount collected, overdue accounts, losses, orders held pending acceptance, and business rejected.

The Credit Department Budget.—In addition to the above, where a budget system is used, it is necessary to advise the management of contemplated collections the following month to permit the planning of the financial budget. This estimate may be readily obtained by referring to the above

reports and chart. It is simply a matter of sizing up previous month's business, observing the trend of sales and receivables, noting the seasonal swing of the business, taking into account conditions in various parts of the territory covered, including prices, noting any specific conditions, and arriving at an approximation of what the collections with ordinary routine efforts should be.

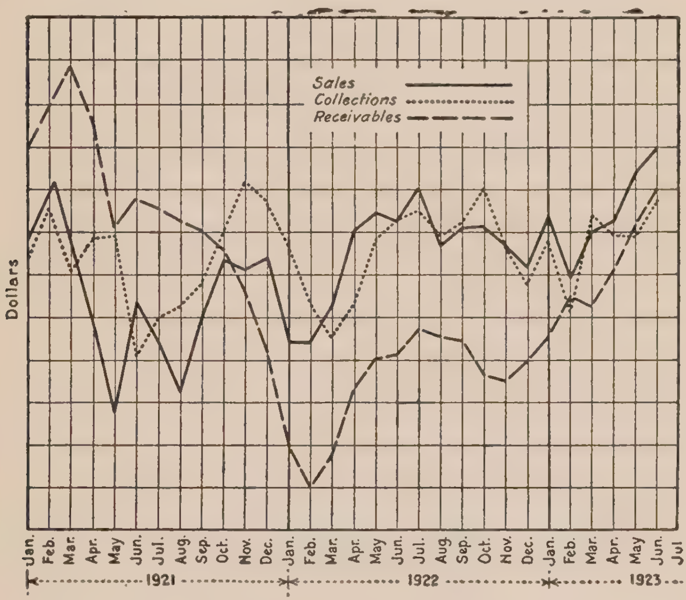

Figure 37. Chart Showing Assembled Branch Office Reports

The following is a convenient form for a credit manager to use in keeping daily check on the estimate of collections furnished the management for budget purposes, Figure 38.

With the estimate of collections and other reports above shown, the credit department should furnish the management an estimate of contemplated expenses. A form like that in Figure 39 may be used for this purpose.

At the end of the year the management should be furnished with a report like that in Figure 39, but giving the total figures for the year, together with percentage of losses to sales, cost of operating the department and its percentage to amount of

CASH RECEIPTS
(Month)

....
1925

ESTIMATE FOR MONTH $..................

Date	Domestic	Total Daily	Foreign	Total Daily
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
....	....	....	....	....
Etc.......	....	....	....	....
Totals:				

Figure 38. Form for Checking Daily Collections

sales. It is well to give with this report a statement of orders that were rejected on credit terms and lost to the business as orders, and the reasons therefor, and also a statement of orders denied credit on original terms but which the credit manager succeeded in having filled on satisfactory terms. A statement

to the management and sales department of customers who have ceased buying from the house should be made.

With such data placed before the management of a house, it may quickly observe whether or not the credit manager is accepting the maximum amount of business submitted, may determine the amount and percentage of losses from bad debts,

CREDIT DEPARTMENT BUDGET

	Estimated	Actual
Salaries	$	$
Office Rent		
Commercial Agencies Service		
Credit Association Expenses		
Stationery and Printing		
Trade Journals and Magazines		
Postage		
Telegraph and Telephone		
Traveling Expenses		
Automobiles and Equipment		
Legal Expenses		
Totals:		

Total collections.. $........

Per cent cost of Department to collections................ ....

Figure 39. Form for Credit Department Budget

may ascertain the extent and investigate reasons for customer turn-over, may determine the actual cost, in amount, and percentage to sales, of conducting the department. What the results really are, as shown to the management by these reports, is a matter resting with the credit manager, and largely determining his worth.

In any business, large or small, it is necessary at times for

the management to secure comparatively large sums of money to meet some approaching obligation. The wide-awake credit manager can anticipate such needs and be prepared to meet the situation by keeping in touch with his management as to extraordinary requirements, and as to routine needs by watching the accounts payable and the bank balances.

The growing importance of the credit manager's work and the increasing complexity of his problems, demand that his qualifications be such as to enable him to keep in constant touch with the management of the house. This will keep him informed of what is needed by the management and what is expected of him, and consequently permit him to fit his department and activities into the general scheme of things. It will the better qualify him for his relationships with the customer, with other departments of the house, with outside agencies, and with other credit men. It will make him realize that he is an instrument of action, whose purpose is to converge and harmonize his efforts with those of others, so that his organization, his house, may move forward as a unit, justifying its existence as an organization in the eyes of the business world.

References

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Part IV.—Completing the Credit Transaction

CHAPTER XIX

COLLECTIONS

Training the Selected Buyer.—The credit chain will be kept intact only when it may be assumed that in the majority of cases the buyers who have been selected have paid their bills or are ready to pay them, at the appointed time. The credit transaction will then be completed, and the organization is ready for additional extension of credit to the same or other individuals in the regular run of business. However, there is generally a minority even among the selected buyers whose payments are not as prompt as they should be, and in consequence take the time and attention of the credit man. These cases call for that extra portion of knowledge of human nature and courage which can be used to train those selected buyers who have not quite come up to par, but who, nevertheless, may become profitable customers of the house.

That firm is most fortunate in which the credit manager is able to take these weaker customers and, through a spirit of helpfulness, train them in the way they should go to the mutual satisfaction of all concerned.

The Credit Manager as a Service Salesman.—In all his ideals of training and in all his attempts to aid in the distribution of business wisdom, the credit manager must not for a moment forget the principles of business upon which his house is organized. He must always remember that he is a credit man because his house sells goods, rather than that his

house sells goods because he is a credit man. He is there to sell his own house as well as to collect money and every collection must be carried on with the idea in mind that the customer is to complete the transaction with increasing enthusiasm for the firm from which he buys.

With so large a part of the sales in modern business enterprises made on credit, the collection end of the work has become a leading essential in business, and is of no less importance than the work of making the sales. Unfortunately though, many business houses do not seem to realize the importance of good qualities in the collector; they very often look upon a collector, or a collection department, as a necessary expense or evil in business, instead of a vital money-producing factor. This attitude, when it exists in a business organization, will often interfere with the success of collections and collection departments, which will in turn constantly interfere with the selling end of the business. After all, it is largely the attitude of the collector that renders his work effective or ineffective. In other words, the spirit of the collector is of equal importance with the material machinery which he may control in making collections. If the collector's mental attitude is not right, if he lacks inspiration, his work will reflect it and usually show corresponding results.

Much stress is usually laid by sales managers upon inspiring salesmen, but the truth is that the skillful collector requires as much inspiration, as much encouragement and support, and as many good qualities as a good salesman. It may be safe to go a step farther and say that the skillful collector needs even more tact and good judgment than the salesman. The salesman is usually helped by the attractive or useful commodity he shows, or by the demand existing with the prospect, but the collector has no such aids. The prospect with whom the salesman deals is in the mental attitude of one who is to receive something in materials or service, but the prospect

with whom the collector deals is always in the mental attitude of one who is parting with some of his possessions. There is a vastly great difference between talking a man into *receiving* something, and talking him into *parting* with something.

Certain conditions and suggestions will produce certain effects on the mind of any individual and will almost invariably lead to the same results, modified by the restrictions of surrounding circumstances. Therefore, if it is known who a man is, what his circumstances are (what he has), and what kind of merchandise or service was sold to him by the house, the collector should be able to tell to some degree what the mental attitude of that man should be toward his bill. It is the task of the skillful collector to be sufficiently acquainted with the facts in the case to know what the mental attitude of the customer under normal conditions should be, and then know what steps to take which will cause that customer to part with his money, if possible, willingly.

The Planned Appeal.—To deal with a man's mental attitude one must first of all, to use a selling term, get a point of contact. This is needed to secure real attention. Then, if the power of habit is known and how to use that power, or how to appeal to a man's reason, motives, instincts, emotions, pride, sense of honesty, etc., spontaneous, automatic response may usually be secured. Also, the power of suggestion that will set the subject's imagination to work should not be overlooked. And here the indirect or implied action is often more effective than the direct. For instance, a statement that certain actions on the part of the customer will compel the creditor to use other means to collect, will be found to have a far better effect on the customer (and in many cases secure the desired result) than when a direct statement is made that unless he does so and so the creditor will take certain steps. The

former phrase leaves a great deal to the customer's imagination, but the latter does not, and he will invariably resent the threat and prepare to defend himself as best he can. Of course, if he is scared at the threat he will pay, but very few are scared at such a threat when this stage of operations has been reached.

The really good collector or correspondent should study his customer, and should know or try to learn something of his station in life, his business or occupation, his habits of living, buying, paying and thinking. To do this and at the same time handle a large volume of correspondence requires the smooth operation of an adequate system.

Retaining the Good-Will of the Customer.—One main thought must be uppermost in the minds of the credit manager and the collector when an attempt is being made to collect the account and still retain the good-will of the customer. It is one of the greatest secrets to successful collecting. It is so simple that most collectors never even think about it, but mechanically continue their humdrum methods of annoying perfectly good customers to no constructive purpose; but more frequently destructive. In determining a man's credit standing, the problem is reduced to three general questions, always to be asked and answered. In collecting the problem is reduced to one general question. When an account is overdue and unpaid, the question should be asked "Why?" Then steps to find out "Why" should be taken. And in finding out "Why," a study should first be made of the account, the records of the transaction, the credit records of who the customer is, what he has and his previous reputation for paying obligations, and then the correspondent should draw upon his imagination, by putting himself in the customer's place, and then acting accordingly.

Relation of Collection Policy to Financial Success.—Collecting the account at maturity and retaining the customer's good-will is the goal after credit has been extended. The efforts of all other departments of a business organization are rendered useless and of no effect if the collection department fails to collect accounts. It is not enough to collect the accounts *sometime;* they must be collected with reasonable promptitude, if the working capital of a business is to function properly and profitably.

The principal source for replenishing the bank balance of a business is the accounts receivable. If accounts are collected promptly the bank balance should, if a business is properly financed, be adequate to permit discounting bills, which frequently plays an important part in the profits. Capital tied up in overdue accounts means capitalizing the other fellow's business to the amount of overdue accounts, and denying your own business the active use of just that much capital and profit-earning power.

In order to keep informed as to the progress of collections it is very helpful for the collection manager, or the credit manager, to study some of the financial ratios in the computation of which the accounts receivable have been included as one of the items. The ratios which may be useful in this connection are as follows:

Current Assets to Current Liabilities
Receivables to Inventory
Total Current Assets (proportion of total assets which are current)
Sales to Receivables

These ratios have all been discussed in the chapter on Financial Ratios so that it is not necessary to go into detail here regarding each one.

It depends entirely upon the nature of the business as to

how the total assets are to be proportioned. If an adequate analysis has been made of the industry so that a norm has been determined for that industry it is very easy to see whether or not the total current assets ratio is rightly proportioned. If it is found that the proportion of fixed assets is excessive steps must be taken to reduce the amount of fixed assets. In other words, it may be found necessary to make some changes in the sales policy or in the collection policy in order to approximate the norm which has been worked out. If no detailed study has been made of the industry the individual concern must make an approximation of the distribution of its assets which will be satisfactory to its particular requirements, and policies must be formed which will serve to keep the business within those limits.

Since the total current assets are to a large extent made up of accounts and notes receivable it is essential to know how this ratio fluctuates. If a fluctuation occurs it is very likely caused by some change in the accounts or notes receivable, and for that reason it is the duty of the credit department and the collection department to keep informed as to such changes.

The sales to receivables ratio is the most important of all financial relations in showing, first, the rapidity with which collections are made, and, second, the efficiency of the collection department in keeping the accounts receivable down to the limit which is determined by the sales policy of the house. It is necessary to know the terms of sale of a concern in order to ascertain what the amount of the receivables should be. If the terms of sale are "30 days" the amount of the receivables carried on the books at any one time, theoretically, should not exceed 30 days' sales. The ratio may be expressed in one of two ways. It may be stated as a 1200% turnover of receivables, or as 30 days' sales. Expressing it in terms of days' sales makes it easier to read and for collection purposes it should be so stated. Chapter XIII shows how such ratios may

be interpreted. A glance at these figures will show the collection department whether or not the collections are keeping the receivables within the margin as laid down by the terms of sale.

Every concern has a more or less clearly defined financial policy. If success is to be attained it is necessary that all other activities must conform to that policy. The terms of sale must be such that they will reflect it, and collections must be made accordingly. If the receivables are too high it means that the concern is financing its customers with its own funds. The principle is the same as if that amount of money were loaned directly to the customer, the only difference being that in the latter case interest would be received for the use of the funds, while usually in the other no interest is collected. For these reasons emphasis must be placed upon following up collections very closely so that the financial structure of the business will not be endangered.

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CHAPTER XX

COLLECTION PROCEDURE

Organization of the Collection Department.—Before an efficient system of collections may be evolved, it is necessary to formulate a definite collection policy that may be stated briefly to the buyer as the "policies of the house" in order that there be no misunderstanding at the time of the initial sale. These policies must define the terms under which the sale is made, emphasizing the date upon which payment becomes due; they must determine in general the bases upon which credit is granted, thus defining that house as liberal or exacting in its credit extension; they must define the limits beyond which an account becomes delinquent and open for collection follow-up.

In the technical task of collecting accounts there are certain fundamental principles which correct management dictates. First, the house should have a definite collection routine which it employs, with slight modifications, in each case of delinquency. Reminders of indebtedness must be prompt and regular. Some form of collection effort should be made at such intervals as the house policy has determined, thus establishing for the house the valuable habit of expecting payment within the stated interval, and leading the debtor to respect the habits of the house. Second, the plan should be so constructed as to enable the house to adjust that policy to the particular case in hand—it should be flexible. To make this adjustment, the collection manager should analyze the facts at hand and come to that decision which will be to the best interest of his house in each case.

The systems employed in keeping informed as to the

progress of collections are various. One method is that of running through the ledger accounts at regular intervals. The frequency of this operation is usually determined by the nature of the business, the distance, and the policy of the house, ranging anywhere from five to thirty days. This plan has some advantages over other systems in that it prevents duplication of records and enables the credit man and the collectors to be familiar with customers' accounts at all times. Where a great number of accounts are handled, certain collectors are made responsible for a certain division of the ledger accounts. A drawback to this plan is sometimes experienced in the interruption of bookkeeping work on the accounts, but this may usually be overcome by splitting up the ledger into the number of separate divisions necessary to accommodate the requirements of both branches of the work. Another disadvantage is encountered when the credit manager attempts to do most of this work himself. He may find himself overburdened with a considerable amount of detail, which a clerk could easily be taught to do, while more important work is being neglected. This is a situation which must not be overlooked by the credit manager—or the collection manager, as the case may be.

Another system of following up accounts which is extensively used is to have bookkeepers, or posting clerks, notify the collection department when accounts become due. Specially prepared forms are usually provided to meet the requirements.

Still another system provides for separate records of accounts in the credit or collection department, in addition to the ledger record. This system overcomes most of the objections to the first method and if handled by way of carbon copies of transactions, requiring no extra work, is about as thorough and inexpensive as any system that can be used.

Whether the routine of collection is under the supervision of the credit manager or of a collection manager, departmental organization must be carefully systematized. If there is a

collection manager, he works in close cooperation with the credit department, ascertaining the facts upon which credit has been granted, and using these facts as his basis for collection follow-up. The first step in careful collection is to forward with the goods purchased a legible, accurate and concise invoice of the purchases. This invoice should state clearly the terms of the sale, any special discount terms, the date when payment for the articles becomes due, the trasportation charges and the route of shipment. Duplicates of these invoices should be filed so that they will come to the attention of the collection department approximately ten days before payment is due, ready for the issuance of a statement should payment not already have been received. It is the general practice that an account becomes delinquent on date due, when a "past due" statement is issued, and then becomes subject to the routine of collection follow-up which lies in the hands of the collection manager. From this time the use of tickler files becomes invaluable, serving as a means for filing information concerning the delinquent accounts at those dates when information from or answers to these delinquencies may be expected. In so filing it is most valuable that the geographical location of the debtor be considered, that enough time may be allowed for the delivery of the letter and a return response. Neglect of this simple check often results in the debtor receiving dunning statements after he has forwarded a settlement of the account, a resultant ill-feeling on the part of the debtor and a possible loss of future orders and of his good-will toward that house.

Depending upon the terms upon which goods are sold, a custom of monthly, semi-monthly or weekly statements will be developed. The policies of the house, expressed by the terms of sale, will be further emphasized by a series of three, four or more reminders which may be issued. It is the problem of the credit manager to fit the suggestion or demand for payment to the individual account in such a way that points

emhasized may be carried out in mechanical applications of the collection process.

The chapters on the organization of a credit department have indicated the type of information found in the customer's file. This data is all available for examination by the credit or collection correspondent and a knowledge of it is essential to good letters and collection follow-up of any kind. All reports, letters, etc., have been flowing into the file ready for use.

Steps in the Collection Process.—There are probably as many definitions of classes of credit risk as there are credit and collection managers. However, these variously defined classes are essentially the same—"the good pay," "the slow pay" and "the bad credit risk." The good pay customer is in the habit of discounting his bills or paying on the date of maturity. If he is unable to do this, he is willing to forward to the credit manager the exact reasons for his delinquencies and to make such special arrangements as seem mutually beneficial. The "slow pay" do not discount their bills, waiting for payment until reminders appear that the bill is past due. Slow pay is largely a matter of habit and lack of understanding of good business principles. One of the great tasks of the collection manager is to educate his buyers to the point of discounting their bills, convincing them of their financial gain in taking advantage of such discounts and of their raised credit standing. Slowness of payment may often be due either to lack of sufficient funds, misfortune or an unforseen happening, or to a supposed dissatisfaction with the goods. These problems tax the ingenuity of the credit manager and his success may be, in part, measured by this ability to secure payment from these people and retain their good-will toward his house.

When the account over-steps the bounds of slow pay and becomes a bad credit risk the ingenuity of the credit manager

is again tested. He should be able to detect and immediately take measures to protect his house from obvious efforts to defraud, issuing further orders, if feasible, on the C. B. D., C. O. D., or part payment basis. It is to be expected in all business organizations that a small percentage of credits will prove uncollectible, to be charged up to profit and loss, but these accounts do not always spring from the bad credit risk. Unforeseen business emergencies may render insolvent the good credit risk or make of the bad risk a customer who in the future discounts his bills. The subsequent attitude of these customers will be determined by their former dealings with the house and the credit manager must be on constant watch for such shiftings of credit values.

The time between sale of the goods and payment therefor may be divided into periods of more or less distinct characteristics. Where payment is prompt collection procedure is only a matter of presentation. The invoice and statement are sent and a check is received in return. If the bill is not paid, the next step is merely an application of the old principle of repetition. This period of repetition may or may not be long. A part of this period may involve the use of rubber stamp warning statements or stickers of one kind or another which call special attention to the fact that repetition has become necessary.

After repetition fails the chief characteristic becomes that of explanation. The burden of proof is on the debtor to show cause why he should not be forced to pay and to reestablish himself in good credit standing by a complete presentation of all the facts in the case. During this time the credit manager is making one last appeal before pressure of one kind or another is to be used.

The final period is that which follows this closing appeal. After the personal appeals showing an underlying understanding of ability to deal with the human element in business

have failed, legal intervention must come. After the credit manager has appealed to those motives underlying business conduct which are universal in their application, *i.e.,* to good-will toward the house, to a sense of justice and fair play, to a sense of honor coupled with a sense of business obligation, to a sense of responsibility, then those sterner measures which involve the protection of the credit chain from breakage, and in some cases the rewelding of that chain after breaking, must be invoked to protect the business structure.

Collection Correspondence.—When statements and reminders fail to get a response from the customer letters or personal collectors are resorted to, distance and house policy again being determining factors as to which is to be used. In the case of letters, the good collector will classify his risk and proceed tactfully.

In utilizing appeals as a basis for collection correspondence there must be a keynote of individuality. This individuality is a reflection of the policies of the house as well as of the human sympathy of the collection manager. The appeal, whatever it may be, must create the impression of efficiency, of cooperation, and above all, of sincerity. Sincerity can only be achieved by viewing the debt from the debtor's angle, by learning the facts of his financial position and of specific economic conditions that may have arisen to cause the present delinquencies, and by then stating the terms of such cooperation as the house is able to offer in plain, effective English.

Essentials of collection correspondence have been defined as clearness, conciseness, completeness, correctness and courtesy. Mr. Fred B. Atwood [1] perhaps states the situation more clearly when he urges the use of English, not hybrid "Law English" in which, if "A" wishes to deed "B" a piece of land it is necessary that "A" have given, granted, bargained, sold,

[1] Atwood, Fred B., "Write English, Not Hybrid Law English," *Credit Monthly*.

remised, released, conveyed and confirmed and by these presents does grant, bargain, sell, remise, release, convey and confirm—in other words, sells "B."

Circular or multigraphed collection letters or those on general forms are not the best means to collect accounts. They may have their place in some lines of business, but on the whole they do more harm than good, and are in the end more costly than a personal letter "that fits the case" in the first place, setting the customer straight as to terms and what is expected of him if he is to maintain his credit standing. With a letter of this kind, the following card, furnished by the National Association of Credit Men, can be profitably used:

DID YOU EVER STOP TO THINK

How seriously *indifference,* and neglect of the correspondence of your creditors, relating to overdue accounts, *affects your credit standing?*

If you cannot remit when due, don't let the creditor guess the reason. He is likely to make an unpleasant guess. Give him the reason straight, and thus encourage that frank relationship between business men that is worth dollars to each.

PROMPTNESS IN CORRESPONDENCE IS ONE OF THE BEST OF CREDIT AND BUSINESS BUILDERS.

NATIONAL ASSOCIATION OF CREDIT MEN
Forty-one Park Row New York City

Emphasis should be placed on the last preceding remarks, by stating that it is poor policy to use "trick" correspondence or "smart" methods in collecting. Those methods may be all right for small concerns that are here today and gone tomorrow, but for a house of good reputation and dignity, having a dependable line of merchandise or service for sale, it is not conducive to building for permanent and cordial relations with the trade. Furthermore, the effectiveness of "trick" methods is lost as soon as the novelty is gone. Sane, personal, "fit the case" collecting will be found to be cheaper and better

in the long run, and the use of such methods is here advocated. If generally practiced it will help overcome some of the evils of slow accounts in business and tend to put business on a better basis.

Collection by personal correspondence is acknowledged to be the most efficient means of reducing outstanding accounts, allowing as it does the use of form paragraphs (which may be made to "fit the case"), allowing also the fitting of letters to the creditor that show terms in "black and white," and also affording access at any time to complete information concerning individual transactions. The basic principles underlying good collection correspondence are the same as those underlying good persuasive intention at any time or for any purpose. Professor James has emphasized the idea in the expression, "What holds attention determines action." Good collection letters will hold attention as against other letters arriving on the desk for attention at the same time. Action cannot take place except after at least a short period of deliberation. If in that period of deliberation the letter of the credit manager can awaken desire for the end sought and can be translated into effective action, it has been a good letter.

Various motives [2] cause men to pay their bills and the well selected appeal stands a good chance to succeed. Though it is sometimes necessary to appeal to particularly selfish motives for immediate action, it is always more effective to join some higher motive with the more selfish one as some like to be able to say that their motives are of the best. This also suggests the idea that the wise letter writer will not always, perhaps not often, mention any motives by name, for the man himself will identify the motive connected with the particular act.

The various motives which beget action must be stirred.

[2] Note: For examples of particular kinds of letters in the field of credit and collection correspondence, the student is referred to books mentioned at the end of this chapter.

In effect the idea is best conveyed by the word "challenge." The idea of a man's attitude toward fair play must be challenged. The credit manager must lay claim to fair play as a consideration of their credit relationships. Few men refuse to yield to the motive of fair play.

Another motive which may be challenged is that of responsibility. No man likes to feel that his business practices are interfering with his community, his trade association or the standing of his club. Most men like responsibility and if identification of the payment of a particular account with a sense of responsibility can be brought about, payment often takes place.

The desire for approval and admiration may also be challenged. A reputation for prompt payment unsullied through the years can often be made a basis for collection. The general publicity arising out of trade reports has done much to make this challenge effective. This is a challenge which often suggests an opportunity to "stand well" in the opinion of others and often times induces extraordinary efforts to meet pressing obligations.

The desire to surpass others furnishes another opportunity for a challenge. Men strive for relative position. They can be persuaded to pay because of a comparison with others. Letters which inspire rivalry in credit habits contribute not only to the individual firm treasury, but strengthen also the economic fabric of the community and nation.

One other characteristic of good letters must be mentioned. They must be written so as to stir the imagination of the reader to see himself fair, to see himself assuming responsibility, or to see himself a leader in good credit practice. Word pictures must suggest possible realities. Action will come largely in proportion to the success gained in stirring the imagination.

Opportunities for increasing sales through credit corre-

spondence are second only to opportunities offered by regular sales promotion letters. The personal friendliness and sympathy of the collection letter, the same motives that make men buy, will bring a large percentage of debtors to a realization of the necessity of paying and a little more of the same elements will produce additional sales after payment is made. Drastic measures should never be used at the expense of the customer's good-will. Let the debtor know that a personal interest attaches to him, a real personal interest that is not measured wholly by orders and his dollars.

Getting the Money from the "Hard" Customer.—When normal methods of collection appeal have failed to bring response from the debtor, the collection manager realizes that he is dealing with the "hard" customer; that he must use all possible human, personal and direct efforts to re-sell his debtor a sense of obligation; that he must make sure that his case is complete before going on record as favoring more strenuous collection procedure.

When the debtor insists upon classifying himself as good but very slow pay, the creditor has recourse to various methods of securing collection. If it is possible to telephone, a verbal message may prove much more forceful than an influx of written ones. The telegram has been used with a great deal of success since such a message suggests urgency and gives a certain measure of publicity to the fact that a bill is past due. Registered letters stamped to be delivered only to the addressee with a return receipt requested serve as a check upon the accuracy of the mailing address of the debtor, thus assuring the company that former communications have been received and neglected or ignored. Some establishments find the forwarding of a letter under the signature of the company's general manager effective after two or three letters have failed to bring response. Others make use of a house collection

agency, issuing requests on the stationery of their agency, and thus placing a more formal and serious aspect upon the indebtedness. Or, it is sometimes possible to secure collection through the assistance of the well-trained salesman who is in the territory and can talk over the indebtedness personally with the creditor. This method imposes great confidence in the ability of the salesman to understand house collection policies, to study and see clearly the situation of the debtor and to handle the situation tactfully.

The credit manager often finds in his possession defective remittances sent through clerical error or, perhaps more often, intentionally made to stop the recurrence of dunning literature or threatened legal procedure and give the debtor those few days of added grace in which to secure the necessary finances and clear the account. The handling of such remittances will depend, of course, upon the type of defect and the credit standing of the account. The collection manager, however, has various methods at his command for correcting the error without returning the check to the debtor—a lengthy and sometimes unwise procedure. When the amount in figures does not correspond to the amount in writing, on the back of the remittance over the signature of the crediting house is written "amount guaranteed," mentioning the correct amount. This is then attached to the letter and deposited. In cases where the check is not inclosed with the letter, a draft is made for the amount specified, deposited with the letter and the debtor notified why the draft has been made. When a check is not signed, over the house indorsement is written "within amount guaranteed," and the check is attached to the letter and deposited. When checks or drafts to the remitter's order are not indorsed, the letter should be examined carefully, the indorsement supplied by the collecting house agent and the check deposited; the letter to be retained as authority of the house to supply the indorsement.

Getting the money from the "hard" customer is often an arduous task. Of initial importance is the securing of the present address of the debtor that the creditor may be assured that he has received former communications and is deliberately avoiding inquiry response. Such debtors may be traced in various ways. The salesman in the field may prove an invaluable aid in securing the address from neighbors, banks or local business concerns. The Post Office may serve as an effective means for tracing. While it is illegal for the postmaster to give the change of address of any party, yet, if the collection manager's mailing list for a given city is sent to him for the purpose of correcting addresses, he is permitted for a fee of 40 cents an hour for clerical labor involved, to correct such a list. Under a postal regulation, Section 551 and 560, Postal Laws and Regulations of 1893, the creditor may provide himself with a rubber stamp to be used on the face of the envelope containing the message to his debtor, which reads.

POSTMASTER

See Sections 551 and 560, P. L. and R. 1893.
Give reasons returned. Check one of the following reasons:
Refused
Unclaimed
Can not be found
Present address unknown
Removed to

Probably the best means of country-wide tracing of debtors is afforded through the National Association of Credit Men. The Association's monthly "Bulletin" lists names and particulars concerning persons wanted. Circulating as the "Bulletin" does among thousands of credit men all over the country, it is possible for the creditor in one section of the continent not only to secure information regarding delinquents who have "skipped" but at the same time to warn others against the possibility of themselves becoming involved in the same way.

When a delinquent refuses to answer but is known to be in the same location and the addresses of business or personal friends can be secured, it is sometimes very helpful to intimate to him that if no response is received to its letters, the house will write to one or more of these persons, merely, of course, to secure information of the debtor's whereabouts. This may bring a certain amount of pressure to bear upon the debtor which will lead to the payment of an account.

Certain facts are now known concerning the debtor—he can be reached at the address to which one or more communications have been sent, and he has persistently ignored the requests for settlement of the account and furnished no adequate reason for non-payment. At this stage it has become the custom to send a draft to the bank of the debtor, enclosing a fee for its collection and requesting its return with reasons for its refusal, if uncollected. Notification should be sent to the debtor that a draft will go forward through his bank. The notification should be brief and to the point, as for example:

> Since we have not heard from you in response to our letters of June 10 and 20 concerning the amount of $35 due on May 1, we shall draw on you July 5 through the First National Bank of Morristown.
>
> Please arrange to take care of this upon presentation.

This may be a more or less severe means of securing payment, depending upon the custom of payment in the particular line of business. If the customer is in the habit of paying for goods in this manner, the draft becomes only a regular, impersonal method of collection. If, however, a draft is seldom used, it appears drastic and in some cases may be interpreted as an unfriendly step and thus have an undesirable effect on the collecting house. The fact that a draft is presented on the bank of the debtor has a strong psychological effect in that the customer is generally desirous of keeping on

the best of terms with his own bank and does not wish to be known as a man who has neglected to pay his bills at the proper time. Individual circumstances will, of course, determine whether or not the refusal to pay a draft is as serious as first indicated. A debtor may return it unpaid because of temporary lack of funds, or a debtor resentful of the sending of the draft might pay no attention to it, and others who might consider the draft a suggestion that their credit was weak would retaliate by making the payment in some other way.

When it is to be assumed that the debtor has resisted all reasonable efforts to bring about the settlement of the account through an explanation of the unusual circumstances which may have delayed payment, no choice remains but to enter the final stage of collection procedure. Even here the collection manager's purpose is to get at the underlying causes of nonpayment, and in so doing to force the delinquent into the position where he must pay or explain, if he would avoid the inconvenience and the expenditure of time and money which he knows will surely follow legal action.

Appeals to the fear of consequences from continued neglect are conveyed in the form of veiled or open threats. However, they must be used with greatest caution or they may defeat their own ends and involve those who use them in most unpleasant consequences. A common form of conveying a collection threat is that which explains that as a member of a trade or credit association, the creditor is required to report all slow and delinquent accounts in order that others of the association may not suffer loss through credit granted to the same habitual delinquents. Such a threat is well within the collector's rights because that is the common practice among cooperative associations offering legitimate protection.

After having threatened legal action, it behooves the collection man to prepare himself to carry out this threat. There is a distinct advantage in retaining control of such claims so

long as there is the least chance of last minute payment. It is quite customary, on this account, to threaten quick action by a collection agency or attorney, but instead of actually referring the claim at once to an outside collection agency, to install for the immediate purpose an agency of the creditor's own, whose office is in the company's collection department. Suitable letter-heads and stationery are prepared and a brief, new series of letters is written with care to make them different in phrasing and appearance from the house letters that the debtor has been accustomed to receive. The following is quoted from such a letter of a house agency to show how the letter-heads may serve to throw disquiet into the heart of a delinquent. This was printed across the bottom of the sheet:

> Confidential reports of all bills handed us for collection, giving the names and addresses in full, to protect merchants from giving credit to irresponsible parties who are making no effort to pay their honest debts, are furnished by us daily to merchants and professional men—City and County.

The advantage of the house agency lies in the fact that a certain percentage of these "last resort" accounts will be brought to time by the business-like display of the intention to use force. This means a saving in time and collection fees to the house. A still greater advantage lies in the fact that such cases, if once rescued, may by careful handling be revived and even entirely redeemed and reinstated to good standing.

From this stage, collection procedure varies with the case in hand. The house attorney may handle the case, sending a "final notice before suit," and thus marking the limit to the debtor's chance to avoid legal action. To facilitate conditions it may be advisable to secure the aid of a collection attorney in the debtor's locality, thus giving an element of local publicity to the debt. The fees for such collections and the efficiency with which they are made are largely dependent

upon the discretion of the attorney and the amount of business which he has at hand. The merchant's credit associations and commercial collection agencies may prove of great value in that the debtor realizes that he is now dealing with an organized agency impersonal in its attitude and organized for the sole purpose of securing the payment of delinquent accounts.

Drafts, as mentioned previously, sometimes make an effective method of collecting. Some collectors resort to drafts as soon as an account is a little overdue and unpaid, while other houses use the draft only as a last resort before enlisting the services of attorneys. Drafts may be sent to the seller's own bank to be forwarded to its corresponding bank in the customer's locality, or the seller may forward the draft directly to a bank in the buyer's vicinity. Where the latter method is used (especially with banks in small towns) it is well for the seller to forward with the draft a small fee of 25¢ for presenting the draft. If a house is a large depositor at a bank that bank will usually render this service free of charge. When a draft is made on a customer it is customary at the same time, or preferably a day in advance to inform the customer by letter that a draft is being drawn on the account, asking him to be prepared to pay it on presentation. If he fails to do this and gives no satisfactory explanation for his refusal to pay the draft, it usually indicates that more drastic steps are necessary to effect collection, and no time should then be lost in so doing. Much of course depends upon the conditions of the case.

When the claim is placed in the hands of an attorney or agency, it is most essential that a full and accurate statement of the facts in the case should be given. The collector should know whether the debtor obtained the goods through fraud, whether there is reason to believe that it was never intended that the bill should be paid, whether a written statement of assets and liabilities has, upon investigation, proved to be false,

and just what steps have been taken up to the present time to secure the payment of the account. It is a wise policy to leave this responsibility with the collector and not to consume time with requests for reports on collection progress.

Collection attorneys usually furnish a special form of draft, similar to the following:

<table>
<tr><td>STATEMENT</td><td>JOHN DOE</td></tr>
<tr><td>Invoice

....
....
....
....
....
....
....

NOTICE.—In case of error in the account for which this draft is drawn as per above statement, please honor draft and advise us on the discrepancy and it will be promptly adjusted.</td><td>Attorney and Counselor at Law No.......
Security Building, Chicago, Ill.

A copy of this draft is being mailed to the local bank in your town with instructions unless paid to be turned over to a local attorney for collection.
(To be written in red ink.)

.... 192...

At................Days Sight.........
Pay to the order of JOHN DOE, Attorney for collection.

.... Dollars
value received and charge the (with Exchange) same to the account of

.... } ....
........................</td></tr>
</table>

If payment is made on this form usually only 1 per cent collection fee is charged, but if payment is not made, the courtesy of his service entitles him to proceed with collection of the claim in the regular way. For this reason attorney's draft forms should never be used unless you wish the attorney to handle your claim from that point.

Observe that space is left for the itemization of the account on the draft. This usually (especially on long overdue accounts) hurts the pride of the customer, and in many cases he forthwith pays the draft and closes the account.

Personal calls are often effective, but usually expensive. The size of the account, the distance, etc., determine the advisability of using personal collectors. Salesmen, also, are frequently able "on their next round" to collect stubborn accounts, when it is not against the policy of the house to have solicitors or salesmen do the collecting. When they are permitted to do so, they are usually bonded.

Frequently a registered or special delivery letter serving final notice for payment upon the customer secures payment.

When all other usual methods have failed to secure payment of an account, except in cases justifying adjustments, extensions, etc., recourse to attorneys and legal proceedings is necessary. However, the average lawyer is not a good business man and once a claim is turned over to an attorney the customer is usually lost. Attorneys have a very distinct place in handling troublesome accounts for a collection department but great care should be exercised to secure the services of only reputable ones. Frequently collection departments handling a large volume of business have their own legal departments.

Many credit departments use one or two good attorneys in the collection of their bad accounts to whom they turn over all claims which are sent by them to corresponding attorneys in the localities where debtors are located. On account of the number of claims an attorney can thus forward local attorneys the fees are divided, costing the seller no more for the collection of an account, and at the same time relieving him of the necessity of "following up" the attorney located at a distant point. This also assures the seller of securing the services of the attorney best able to give him service

There are many collection agencies in business—some good, some bad. A collection department should use great care in selecting an agency, if it desires to enlist such services; frequently it is more of a problem to secure money from some agencies than to get it from the debtor in the first place.

Particular care should be used in selecting agencies that agree to collect a certain amount on bad accounts in consideration of advance fees.

The large and responsible agencies are perhaps better able to serve the average collection department than many of the attorneys. Some of these agencies publish lists of delinquent debtors for the use of their clients which often are of much value to credit departments. When debtors become aware of this fact they sometimes will pay when other arguments have failed to secure payment. R. G. Dun and Company, in addition to other service provided for their subscribers, conduct a collection department.

Justices of the peace, in small towns, often make very effective collectors. The debtor is frequently personally known to such an official, and it hurts the debtor's pride to have his debts placed in his neighbor's hands for collection.

In whichever way a "hard" account is handled, whether by the attorney within the collection department, the local attorney, the justice of the peace, the collection agency, or by any other method which may be used, one fundamental principle should be followed if it is at all possible. Success is measured by the ability to collect the account only if a certain number of the "hard" customers can be educated by the collection department to finally respect the general policies of the house. For that reason it is of the utmost importance to have the right kind of men making the collections and writing the collection letters.

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CHAPTER XXI

TRADE ABUSES AND CREDIT ETHICS

Bad Habits in Business.—It is quite customary among professional men to discuss what is often termed "unprofessional conduct" or "sharp practice." With the tendency to develop a professional spirit among business men has also come a belief that "tricks of the trade" in business which are unfair and not in accordance with the Golden Rule of business should be noted and marked as "trade abuses." The existence of such a sentiment should gradually develop a popular disapproval which, in the end, would tend to eliminate many of these trade abuses.

In credit transactions there are many opportunities for such trade abuses. The credit contract has many possibilities for violation, most of which, though not serious in and of themselves, are insidious attacks upon the integrity of business and demand a courageous attitude on the part of the intended victims and competitors. Business organizations are fast realizing the possibilities of creating a sentiment of business ethics, such as is expressed in the *Credit Monthly* of January, 1923:

> The Committee expresses a unanimous and firm belief that a stronger and more courageous attitude should be shown toward the violation of credit contracts that are commonly designated as trade abuses. It stands to reason that if this attitude were displayed, trade abuses would be checked.
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> The cancellation of orders given and received in good faith, the return of merchandise without justification or permission, the improper deduction of discount, the making of unjust claims and failure to meet terms of sale are very expensive, are very costly when properly analyzed, and, on the whole, cause severe losses to creditors and debtors. This loss is material and moral.

> We appeal as a Committee for a wise appraisal of the real effect of trade abuses and for a better understanding with all parties to trade agreements, that contracts entered into must be carried out, else losses will happen and strains be placed unnecessarily on the commercial relation of people with one another. There must enter into the situation a sense of human justice and commercial honor. The creditor must insist and be satisfied with nothing less than the proper treatment of contracts. The debtor must be satisfied with nothing less than to execute his contract properly.

Taking of Unearned Discount.—The term "cash discount" should better be designated as "cash premium," for that is in reality what the 1 or 2% off for ten-day payment is. The new term would help in overcoming some of the confusions and evils that make the cash discount one of the annoying questions in the credit department. The origin of the difficulty with the cash discount is that the taking of the premium is left to the honor and good faith of the buyer, who does not want to miss the chance to make an important additional profit. The result is that if the moneys are not available or banking facilities are insufficient to permit the sending of a check within the specified time, the buyer feels that he must take the premium nevertheless and has been allowed to get the notion that these extra days will make no material difference.

Very few credit men have escaped experience with the taking of discounts after the time set, even though a few days of grace may customarily be given. The amount of the discount and the terms upon which it is granted are definite parts of the sales contract and really represent one element in the consideration of such a contract. It is hard, however, to impress the person accustomed to take advantage of this discount period with the idea that it is the same as a remittance of $2.40 a dozen for a particular variety of canned goods when the original contract called for the price of $2.45 per dozen.

When a group of wholesale firms was questioned in connection with this practice of taking unearned discounts the fact was revealed that 112 never allowed cash discounts after due date; 56 admitted that they allowed it; and 79 indicated that they did it "in some cases," or "sometimes," or "on exceptions."

As to the service which the cash discount performs in dividing buyers into two general classes, there is little room for argument. The rate is generally higher than the current rate of interest and so every buyer who can possibly do so will take his discounts, either with the fund which he has available, or with funds which he can make available through the use of his bank. This is a definite way of dividing the superior credit risks from those not so good, and, as such, has served as a means of judging credit standing by large numbers of credit men. Inasmuch as this tends to drive the buyers to the bank for more funds, the bank is called upon to measure the credit of the buyer. The mercantile firm which gives a discount finds itself borrowing from the bank in order to carry the weaker accounts, thus in effect assuming the liability for its own borrowing in relation to the poor credit risk, while with the discounting customer he assumes no liability at all.

Interest on Overdue Accounts.—Many creditors take more time for payment than the terms of the contract allow. When they do, they are, in fact, using borrowed capital, capital which belongs to the seller for the purpose of financing his own individual business. If much of this is done the effect on the working capital of the seller is hazardous, and, to meet the situation, many firms charge interest on past due accounts. As not all houses do this it is necessary for those who have adopted such a policy to carry a notice on all orders, invoices and statements that this rule is to be enforced. The very fact that a statement carries such information is, however, not an unmixed evil in that some firms noticing this amount and inter-

est rate might decide that such a loan would be advantageous at such a rate of interest. They would then accept the interest charge without qualification and continue an undue credit extension policy indefinitely, in many cases approaching a dangerous conclusion.

There is, of course, no question as to the legality of this interest charge. The house which grants an extension of credit beyond the regular terms is entitled to this amount. One writer puts it as follows:

> If $500,000 worth of accounts discount at 1% in 10 days, the deduction would be $5,000. If $500,000 of the accounts are carried 20 days beyond the net period of terms, the cost rightly should be computed at 1% for each 10 days' excess time, or it is costing $10,000 a month to carry overdue accounts, were there no redeeming features to that account. It is, of course, illegal to charge interest at the same rate as the rate of discount shown, but if it is worth $5,000 a month to a business to get $500,000 back into the bank account, is it not a fair premise that the customer should always be charged legal rate of interest for excess time taken if he becomes an habitual offender?

Claims for Shortage.—Claims for shortage in shipments are sometimes just claims, but inasmuch as such shortage would serve as a convenient loophole by which the buyer could consider his contract broken or place a claim for goods already received, the responsible houses at present make it a practice to have every shipment checked so that they are able to submit an affidavit of the contents. With every invoice is sent a copy of the shipping list which has been checked with the merchandise consigned to the carrier by at least two persons. If a claim for shortage is presented, the buyer must then submit a similar affidavit of shortage and these two are then presented to the carrier as proof that the goods have been lost in transit. Such careful checking of merchandise has greatly reduced the number of unjust claims, and by leading to more careful check-

ing of goods in transit, has reduced the number of damage claims.

Should a shortage occur, it is the custom of the seller to handle shortage claims with the carrier even though, if the merchandise is sent "freight prepaid," his responsibility ceases upon the delivery of the goods to the carrier. The handling of these claims is an excellent means of rendering valuable service to the customer and of increasing his goodwill toward the house.

Cancellation of Orders.—The cancellation of orders is a trade abuse which generally represents the violation of contract and as such should not be tolerated, though often it is tolerated. The New York Chamber of Commerce, commenting on the way of cancellations, states that it has found through investigations covering the United States in various lines of business that cancellation evils have become a highly menacing fact in commerce. As a remedial measure they urge that contracts should include a frank cancellation clause. Their resolutions are of interest as an indication of the new business attitude toward the cancellation of contracts:

> That the Chamber of Commerce of the State of New York deprecates the present tendency among many buyers of goods to cancel their orders or repudiate their contracts;
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> That an effort should be made on the part of the business community to incorporate into written contracts a frank stipulation respecting cancellations, in order that business may be established on a clear and definite contractual basis, and that the possibilities of misunderstanding and disagreement may be lessened and an element of dangerous uncertainty be removed; and
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> That the Chamber of Commerce urges upon the business and banking communities that buyers who disregard their written agreements shall be considered as being lacking in business morality and as undeserving of confidence; and that business and banking leave no doubt that attempts wilfully to violate contracts shall be frowned upon as violating the code of business ethics on

which rests the entire structure of American industry, commerce and trade.

When the buyer was prevented by one method from avoiding the acceptance of goods on which there had been a decline in price between the time of placing the order and the delivery date, he discovered a new method which is causing its share of difficulty to the credit men. About the time a bill comes due, a complaint is entered about part of the merchandise and that part shipped back to the seller. Having got the undesired merchandise back to its source, he forwards a check for the difference between the merchandise kept and that returned, marking the check "In full of account." If the seller accepts and deposits this check he has no further recourse, for he has virtually admitted that there has been dispute as to the amount of the claim and has accepted payment "in full of account." Checks with such notations should not be accepted if there is any complication arising from disputes as to any portion of the outstanding account or any part of the merchandise covered by outstanding accounts.

In the Credit Men's Platform, adopted at the Twenty-Seventh annual convention of the National Association of Credit Men, the following sentiment on contract observance was expressed:

> Contract Observance: Building up the backbone of the credit profession must be a part of the platform. Contract observance should be the slogan of the credit department, to be observed by its own enterprise and by customers. We can drift into immoralities by glossing over the violations of contracts. The word of an American business man should be as firm as Gibraltar's rock. It is a part of the credit task to insist upon contract observance even though the immediate reaction in many instances might be unpleasant and some accounts may have to be lost. It is better to lose many accounts than to violate or permit the violation of contracts.

Defective Remittances.—Defective remittances constitute a further trade abuse and source of worry to the collection manager. Checks are received unsigned, with discrepancies between the amount specified in writing and the amount in figures, or the check may be returned marked "Not sufficient funds." In the case of the unsigned check it may be deposited with the understanding that indorsement is to be secured by the bank on which the check is drawn; or it may be deposited with a sight draft attached. Discrepancies in amount specified in writing and in figures may be corrected by indorsing the check "Amount guaranteed." The "Not sufficient funds" problem is usually solved by leaving the check with the bank on which it is drawn with the understanding that as soon as sufficient funds are deposited to cover the check the bank will certify it and return it to the holder. Many credit men notify the customer and redeposit the check; some take drastic steps "giving 48 hours to cover"; some put the account on a C. O. D. or cash basis immediately on a second offense.

Among other trade abuses is the refusal to pay for goods until their arrival. If the terms of contract offer a cash discount and the goods have not been received when payment becomes due, many buyers, to take advantage of the discount, ignore the discount limits and remit less the discount when the goods have been received and the order verified. A trade abuse that is essentially the same is that of antedating the check to the date when discount payment is due and holding the check until such time as the order has been received. Such conduct implies lack of confidence in the house with which the buyer is dealing, is a direct withholding of payment, and, as such, is a violation of the terms of contract.

Divulging Sources of Information.—Ethical standards of credit men demand that they never violate a confidence in regard to the source of the information which they have re-

ceived concerning an applicant for credit. Such information is generally given in absolute confidence for use in the granting of credit extension. Very few credit men ever violate this principle of business ethics. It is especially important that care be taken to prevent the use by sales departments of credit information. The credit manager ought to be able to maintain his position in a credit risk without giving all the sources of his information.

Ethical Standards.—Ethical considerations deal not only with business transactions, but also with the human element in these transactions. The National Association of Credit Men has attempted to set up in brief form the ethical standards which it would like to have all its members follow in the transaction of business:

Canons of Commercial Ethics Adopted by the National Association of Credit Men

I. It is improper for a business man to participate with a lawyer in the doing of an act that would be improper and unprofessional for the lawyer to do.

II. It undermines the integrity of business for business men to support lawyers who indulge in unprofessional practices. The lawyer who will do wrong things for ONE business man injures ALL business men. He not only injures his profession, but he is a menace to the business community.

III. To punish and expose the guilty is one thing; to help the unfortunate but innocent debtor to rise is another; but both duties are equally important, for both duties make for a higher moral standard of action on the part of business men.

IV. In times of trouble the unfortunate business man has the right to appeal to his fellow business men for advice and assistance. Selfish interests must be subordinated in such a case, and all must cooperate to help. If the debtor's assets are to be administered, all creditors must join in cooperating. To fail in such a case is to fall below the best standards of commercial and association ethics.

V. The pledged word upon which another relies is sacred among

business gentlemen. The order for a bill of goods upon which the seller relies is the pledged word of a business man. No gentleman in business without a reason that should be satisfactory to the seller, may cancel an order. He would not ask to be relieved of his obligation upon a note or check, and his contract of purchase and sale should be equally binding. The technical defense that he has not bound himself in writing may avail him in the courts of law but not of business ethics.

VI. Terms of sale as a part of a contract touching both net and discount maturity, are for buyer and seller alike binding and mutual, unless modified by previous or concurrent mutual agreement.

No business gentleman may, in the performance of his contracts, seek small or petty advantage, or throw the burden of a mistake in judgment upon another, but must keep his word as good as his bond, and when entering into a contract of sale faithfully observe the terms, and thus redeem the assumed promise.

VII. It is always improper for one occupying a fiduciary position to make a secret personal profit therefrom. A member of a creditors' committee, for example, may not, without freely disclosing the fact, receive any compensation for his services, for such practices lead to secret performances and tend to destroy the confidence of business men in each other. "No man can serve two masters."

VIII. The stability of commerce and credits rests upon honorable methods and practices of business men in their relations with one another, and it is improper for one creditor to obtain or seek to obtain a preference over other creditors of equal standing from the estate of an insolvent debtor, for in so doing they take, or endeavor to take, more than their just proportion of the estate and therefore what properly belongs to others.

IX. Cooperation is unity of action, though not necessarily unity of thought. When the administration of an insolvent estate is undertaken by the creditors through friendly instrumentalities, or when after critical investigation creditors representing a large majority of the indebtedness advise the acceptance of a composition as representing a fair and just distribution of a debtor's assets, it is uncooperative and commercially unethical for a creditor to refuse the friendly instrument or the composition arbitrarily and force thereby a form of administration that will be prejudicial and expensive to the interests of everyone concerned.

X. Our credit system is founded on principles, the underlying

elements of which are cooperative and reciprocity in interchange. When ledger and credit information is sought and given in a spirit inspiring mutual confidence, a potent factor for safety in credit granting has been set at work.

The interchange of ledger and credit information cannot fulfill its best and most important purposes unless guarded with an equal sense of fairness and honesty by both the credit department that asks for the information and the credit department that furnishes it.

Recognizing that the conferring of a benefit creates an obligation, reciprocity in the inter-change of credit information is an indispensable foundation principle; and a credit department seeking information should reciprocate with a statement of its own experience in the expectation of getting the information sought; and a credit department of which information is sought should respond fairly and accurately because the fundamentals of credit inter-change have been observed in the manner the request was made of it.

Failure to observe and defend this principle would tend to defeat the binding together of credit granters for skillful work—a vital principle of the credit system—and make the offending department guilty of an unfair and unethical act.

XI. The foundation principle of our credit structure—co-operation—should dominate and control whenever the financial affairs of a debtor become insolvent or involved, that equality thereby may be assured to the creditors themselves and justice to the debtor.

The control of any lesser principle produces waste, diffusion of effort and a sacrifice of interest, material and moral, with a separation of creditor and debtor that is offensive to the best laws of credit procedure.

Cooperation and unity save, construct and prevent; therefore, individual action pursued regardless of other interests in such situations, whether secretly or openly expressed by either creditor or debtor, is unwise and unethical.

XII. The healthy expansion of commerce and credits, with due regard to the preservation of their stability and healthfulness, demands an exact honesty in all of the methods and practices upon which they are founded. Advertising is an important feature in business building; it should represent and never misrepresent; it should win reliance and never deceit; it should be the true expression of the commodity or the service offered. It must be deemed, therefore, highly improper and unethical for advertisements to be so phrased or ex-

pressed as not to present real facts, and either directly or by implication to mislead or deceive. In this department the finest sense of honesty and fairness must be preserved, and the right relations of men with one another in commerce and credits clearly preserved.

XIII. Permanent success cannot be divorced from character.

Character is indestructible as a granite boulder against which waves of circumstances beat in vain.

Character does not cringe or falter before difficulties.

Character cannot withhold that which belongs to others, though secretiveness may not be difficult.

Character is the guarantee of justice and fairness in all personal relations.

Therefore, the debtor who does not redeem his credit to the point of exhaustion, who when embarrassed or insolvent does not give to his creditors all that is theirs, who retains for himself something which is not his, is unethical, and deficient in character, the most important element of the credit relationship.

XIV. The use of credit in the processes of exchange demands utmost frankness of him who promises future value for present value received. Our whole credit structure rests upon confidence on the part of the creditor and good faith on the part of the debtor. This delicate structure is seriously injured if the debtor disposes of the value received or their equivalent out of the ordinary and well-established courses of business without some form of notice to those who have extended him credit.

The sale, assignment or transfer of open accounts receivable without some form of publicity readily accessible to those who hold the obligation of the seller, assignor or transferer constitutes a character of transaction perilous to the foundation of credit, and therefore, unethical.

XV. When in the exchange of commodities for credit there is a promise, expressed or implied, to give for immediate value received the equivalent at some ascertained time in the future, the contract should be faithfully executed. When unforeseen disabilities occur or reasons beyond the debtor's control, it is not proper for him to extend the terms arbitrarily or refuse to compensate his creditors for the accommodation. Interest determined by the legal rate of the state of contract should be allowed for the extended time and a refusal to allow interest for the accommodation violates the sanctity of the contract, is dangerous to the credit relation and therefore unethical.

XVI. The offer of a debtor to satisfy his debts at less than their face value constitutes a transaction in which extreme candor and honesty must control. A composition that does not represent the utmost ability of the debtor to pay is dishonest. Any secret arrangement whereby a creditor receives a larger sum proportionately than is received by other creditors of equal standing is a reprehensible and unfair conspiracy.

In the entire field of credit confidence no transaction demands higher ethical standards, entirely devoid of unfair and dishonest practices, where the creditors should exercise the greatest diligence, than when a debtor seeks by composition to be relieved of the payment of any portion of his fairly contracted debts.

References

Brewster, Stanley F. Legal Aspects of Credit, Chap. XXII.
McAdow, Finley H. Mercantile Credits, Chap. XI.

CHAPTER XXII

LEGAL REMEDIES

The Application of Law to Credit Problems.—It is not intended that the credit manager should be a practicing attorney able to prosecute and defend cases arising in his business. There is, however, a firm conviction common to most credit men that a knowledge of the particular branch of the law relating to their chosen line of work will make it possible for them to serve and protect the interest of the houses they represent. Credit transactions involve exchanges of economic goods and with the credit element added, the chances of dispute are naturally increased many times. The credit manager finds himself face to face with some one of the more common legal problems every day. In procedure and in numerous points the laws vary in different states and it is not intended to do more than to sketch the general outlines of the principles involved. The more important topics include the legal questions involved in buying and selling goods such as those of the Unpaid Seller's Lien, Stoppage in Transit, Rescission, Resale, Attachment, Garnishment, Replevin and the Bulk Sales Law.

General Considerations of Contract.—The different states of the Union have their own statutes applying to the contract of buying and selling. However, many states have passed what is known as the Uniform Sales Act.

According to the act, contracts for the sale of goods above a certain amount (varying in different states), are enforceable only if the buyer accepts part of the goods and actually receives them, or gives something in earnest to bind the contract, or in part payment, or unless some note or memorandum of the

contract be in writing, signed by the party to be charged or by his agent.

The seller may bring action for the purchase price if title has passed to the buyer and there is wrongful refusal to pay, and, irrespective of passage of title, may bring action if a certain date has been set for payment.

An action may be maintained for damages for non-acceptance if the buyer wrongfully neglects or refuses to pay for the goods and also if the buyer repudiates the contract of sale and gives notification to the seller to proceed no further in carrying out the agreement. Any expense of the seller after such notice is not recoverable.

The Unpaid Seller's Lien.—Even if title to the goods has passed to the buyer, there are certain conditions which may set up a right known as the unpaid seller's lien, enabling the seller to retain the possession of goods.

A seller is still unpaid if he has been given a bad check or note in exchange for the goods.

A lien is the right of one to hold or control and retain or enforce a charge against the property of another until some claim of the former is paid or satisfied.

Under the unpaid seller's lien right, the unpaid seller has a lien on the goods, even though the title or property to the goods has passed to the buyer, and may retain them for the price while he is in possession of them. The right of lien by the seller exists until the tender or payment of the purchase price. In cases where no terms of credit have been extended the seller is in possession of the goods as agent or bailee of the buyer but may retain them until paid. If credit is extended and the terms have expired, the lien right also exists. If credit is extended, and, if during the credit period the buyer becomes insolvent before delivery of the goods, the right to exercise an unpaid seller's lien vests in the seller and he may

refuse to deliver the goods on the theory that one of the implied conditions under which credit was extended was the financial standing of the buyer which has now been impaired.

An unpaid seller loses his lien when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the property in the goods, or the right to the possession thereof, or when the buyer, or his agent, lawfully obtains possession of the goods, or by specific waiver of the seller. The fact that a judgment or decree for the purchase price of goods has been secured by the seller does not act as a waiver of the lien.

Stoppage in Transit.—In the preceding section we have suggested that, as a general rule, the seller who has parted with the possession of merchandise cannot avail himself of this mode of protection. Delivery of goods to a carrier presumably extinguishes the unpaid seller's lien. The right of stoppage in transit is an exception to this rule. Even though title passes to the buyer when delivery was made to the carrier so that the buyer is responsible for the loss of the goods, yet the right of possession can be regained and, if insolvency without payment on the part of the buyer occurs while goods are in transit, such recovery may take place.

Goods are deemed to be in transit from the time they are delivered to carrier and after the time of rejection of the goods by the buyer, even if the seller has refused to receive them back, and they continue in the possession of the carrier or other bailee. Goods are said to be no longer in transit if delivery is obtained by the buyer or his agent before arrival at the point of destination or if the carrier has become the bailee for the buyer or his agent by acknowledgment to him on arrival of the goods at the point of destination even though further destination has been indicated by the buyer.

The exercise of the right is by obtaining actual possession

of the goods, or by giving notice of the claim to the carrier, or other bailee, in possession of the goods. Notice may be given either to the person in actual possession of the goods or to his principal. If given to the principal it must be given at such time and under such circumstances that the principal by the exercise of reasonable diligence may prevent a delivery to the buyer. When such notice is given the carrier must redeliver the goods to, or according to the directions of, the seller, the expenses of such delivery being borne by the seller. If a negotiable instrument of title representing the goods has been issued by the carrier or other bailee he shall not be obliged to deliver or be justified in delivering the goods to the seller unless such document is first surrendered for cancellation.

The Right of Resale.—The seller who has possession of the goods through exercise of the unpaid seller's lien rights or through the right of stoppage in transit does not yet have title. Title is in the buyer. If the buyer does not exercise his right to tender the purchase price and claim the goods within a reasonable time, the seller may resell to a third person giving title thereto, and really acting as agent to the buyer to realize on his lien rights. These goods may be resold (1) if they are of a perishable nature, (2) if by contract the right of resale has been reserved on default of buyer, (3) if default has existed for an unreasonable length of time.

The sale may be public or private. Notice should be given but is not necessary to the validity of the sale.

The Right of Rescission.—If a seller has not yet parted with his goods or if he has recovered his lien through the exercise of his right of stoppage in transit he may under certain circumstances rescind the transfer of title and resume ownership of the goods. These circumstances include (1) express

reservation of the right of rescission in case of the buyer's default, (2) excessive length of period of default, (3) repudiation of the sale by the buyer.

On such rescission the seller resumes title or property in the goods, and is not thereafter liable to the buyer upon the contract to sell, but may recover from the buyer for damages sustained. Title or property in the goods is not deemed to pass back to the seller until his intention to resume the same has been evidenced by some overt act, as by notifying the buyer of such intention.

Attachment.—Attachment refers to a seizure or taking into custody by a creditor of a debtor's property by virute of a legal process. A lien on property is secured for the benefit and protection of creditors so that property may be compelled to answer for the obligation. It is found particularly useful in situations where it is possible for assets which are ample at one date, to be found in greatly diminished quantity or perhaps entirely missing at a later date.

Attachment is a statutory right and is available only on the grounds specifically set up in each state. Generally speaking, grounds for attachment include:

1. Non-residence of defendant. This makes property of resident of other states subject to attachment. Leaving the state with intent to make another place his home makes him a non-resident immediately. The fact that a man remains in a state during business hours does not make him a resident if he lives in another state.

2. That the debtor has left the state with the intention of escaping creditors. This does not necessarily mean that he must plan to remain away permanently but merely that in so doing he seeks to avoid creditors.

3. That the debtor conceals or hides himself within the

state in order to avoid creditors. This infers that the debtor gives false information and does actually conceal himself to such an extent that he cannot be served with process.

4. That the debtor has concealed, removed, or is about to dispose of his property in order to prevent the just payment of his debts. In connection with removal of property from the state the essential point is proof of purpose of removal. The transportation of goods in the ordinary course of business would not constitute grounds for attachment.

Disposal of property refers to any kind of separation from it where intent to escape or delay creditors can be shown.

5. That property has passed into the possession of the debtor on the basis of false presentation of fact regarding financial statements.

6. That there has been a violation of the Bulk Sales law. Such violation gives right to revert to any legal process for recovery of property and attachment is one of these.

The credit manager must necessarily familiarize himself with all the details covering this process in his state and govern himself accordingly.

Garnishment.—If the property of a debtor has been transferred for the purpose of defrauding creditors, it is possible in most states to hold the transferee liable as trustee for the property and its proceeds. It is a proceeding by which a plaintiff attempts to reach rights or property of a defendant by holding legally a third party who may have in his possession the rights or property of the defendant. It is a statutory remedy and the basis and procedure for action vary in the different states. The garnishee in each case is considered the secondary debtor and if he transfers any property or funds after garnishment, he is not relieved from liability to the creditor.

Replevin.—The right of retaking goods delivered to a debtor who cannot pay his bills is more desirable than a judgment which cannot be collected. This right exists in case of fraud. In order to maintain this action the creditor must give bond to protect the debtor from wrongful separation from his property.

The Bulk Sales Law.—Legislation known under a heading similar to this has been passed in all the states attempting to protect creditors from fraud in connection with cases where stocks of goods are sold at depreciated values and the proceeds dissipated beyond recovery by the creditors. Often the debtor made the sale to a confederate and split the proceeds.

The New York Bulk Sales Statute is said to be one of the best and illustrates the type of bulk sales legislation.

> Section 44. Transfer of goods in bulk.—1. The sale, transfer or assignment in bulk of any part or the whole of a stock of merchandise, or merchandise and of fixtures pertaining to the conducting of the business of the seller, transferrer or assignor, otherwise than in the ordinary course of trade and in the regular prosecution of said business, shall be void as against the creditors of the seller, transferrer or assignor unless the seller, transferrer or assignor and the purchaser, transferee or assignee shall at least five days before the sale make a full and detailed inventory, showing the quantity and, so far as possible with the exercise of reasonable diligence, the cost price to the seller, transferrer or assignor of each article to be included in the sale, and unless the purchaser or transferee, or assignee demand and receive from the seller, transferer or assignor, a written list, of names and addresses of the creditors of the seller, transferrer, or assignor with the amount of the indebtedness due or owing to each and certified by the seller, transferrer or assignor under oath to be a full, accurate and complete list of his creditors and of his indebtedness; and unless the purchaser, transferee or assignee shall at least five days before taking possession of such merchandise, or merchandise and fixtures, or paying therefor, notify personally or by registered mail of every creditor whose name and address are stated in said

list, or of which he has knowledge, of the proposed sale and of the price, terms and conditions thereof.

2. Sellers, transferrers and assignors, purchasers, transferees and assignees under this section, shall include corporations, associations, co-partnerships and individuals. But nothing contained in this section shall apply to general assignments for the benefit of creditors, to sale by executors, administrators, receivers, trustees in bankruptcy, assignees under a voluntary assignment for the benefit of creditors of any officer under judical process.

3. Any purchaser, transferee or assignee who shall not conform to the provisions of this section shall upon application of any of the creditors of the seller, transferrer or assignor become a receiver and be held accountable to such creditors for all the goods, wares, merchandise and fixtures that have come into his possession by virtue of such sale, transfer or assignment: Provided, however, that any purchaser, transferee or assignee, who shall conform to the provisions of this act shall not be held in any way accountable under this section to any creditor of the seller, transferrer or assignor or to the seller, transferrer or assignor for any of the goods, wares, merchandise or fixtures that have come into possession of such purchaser, transferee or assignee by virtue of such sale, transfer or assignment.

There are various points of difference in the state statutes and a mention of each will indicate the points which are essential to the operation of the law. It is, for instance, necessary in all except three states of the Union to notify the creditors direct of a sale that is made. In those states which do not require notification of the creditors, the notice of sale must be recorded officially, generally in the office of the Recorder of the county where the business is located. The question of notification shows still greater variation. In 39 states the purchaser must notify or record. In 3 states the seller must take care of the notification. In 2 states the purchaser or seller is responsible. There is also some variation in the effect on the sale of a failure to comply with the law. In 15 states the sale is void. In 17 states it is fraudulent and void. In 7 states it is presumed fraudulent and voidable, *prima facie*

evidence of fraud and void, conclusively presumed fraudulent and void, *prima facie* void, and voidable.

In California the notice of sale must be recorded and a period of seven days given for the presentment of claims. The recording must be done by either the purchaser or seller in the office of the County Recorder where the stock is situated. If the provisions of the law are not followed, the sale is fraudulent and void.

The most uniform requirement of the various state statutes is that which provides that a certain number of days' notice must be given concerning the sale of a business in bulk in order to give creditors a reasonable time in which to attach the merchandise stock, or fixtures, or resort to any other forms of legal process competent to recover the assets for the payment of their claims. Failure to comply with the statute makes it possible for the creditor to have a receiver appointed or have the purchaser declared a trustee of the goods for the benefit of the creditors of the seller. The real convenience of the law arises out of the fact that the unpaid creditor need only show that the sale took place without conformance with the law, to throw burden of proof on the seller. The statute applies when a major part of the sale is in bulk. In some states failure to comply renders the sale void, making the goods subject to attachment, in others it renders the sale or transfer both void and fraudulent, and in some states the effect of non compliance is to create a presumption of fraud but until fraud is proved the sale stands.

False Statement Legislation.—The financial statement may be said to be the skeleton to which all other credit facts are related as flesh and sinew to give the completed credit report. It is obvious therefore that great care should be used to secure truthful and reliable financial statements. It is a part of the credit man's duty to verify so far as possible bank balances and

outstanding obligations such as notes payable and accounts payable.

The most dependable financial statement is that which has been properly certified by a duly accredited auditor. The certification is a statement of the auditor that certain work has been done and that the report as submitted is correct. The audited statement which is merely signed by the accounting firm is not ordinarily satisfactory, as in many cases the subject's books have only been superficially examined and a complete check has not been made. If an accountant's certificate stating what has been done can accompany every audited statement, it is more valuable as a basis for granting credit. The certified public accountant is always torn between two inclinations, that of protecting himself from any possible liability for statements made and the desire to make as complete a statement as is possible on the basis of the facts at hand and made available to him by the firm for whom he is making the audit.

It will be noted that the first part of the model form adopted by the National Association of Credit Men as shown in Figure 17 includes what is known as the affirmation. This affirmation is dated. It should state that the purpose of such affirmation is to do business on credit and that any change in the financial condition will be followed up by a new statement at the proper time.

This particular statement signed by an authorized representative of the company is intended to bring the transaction within the perview of the false statement laws of as many of the states of the Union as possible.

There is a movement at the present time to pass a uniform false statement law in all states of the Union just as there is a uniform negotiable instruments law in practically every state. This proposed model law was passed practically without change by New York in 1912. An actual quotation of this law will probably serve a double purpose by defining what constitutes a

false statement as well as giving the penalty attached to the making or issuing of a false statement. It reads as follows:[1]

Any Person

1. Who shall knowingly make or cause to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with intent that it shall be relied upon, respecting the financial condition, or means or ability to pay, of himself, or any other person, firm or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring in any form whatsoever, either the delivery of personal property, the payment of cash, the making of a loan or credit, the extension of a credit, the discount of an accounts receivable, or the making, acceptance, discount, sale or indorsement of a bill of exchange or promissory note, for the benefit of either himself or of such person, firm or corporation; or,

2. Who, knowing that a false statement in writing has been made, respecting the financial condition, or means, or ability to pay, of himself or such person, firm or corporation in which he is interested, or for whom he is acting, procured, upon the faith thereof, for the benefit either of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in the first subdivision of this section; or,

3. Who, knowing that a statement in writing has been made, respecting the financial condition, or means, or ability to pay of himself or such persons, firm or corporation, in which he is interested, or for whom he is acting, represents on a later day, either orally or in writing, that such statement theretofore made, if then again made on said day, would be then true, when in fact, said statement if then made would be false and procured upon the faith thereof, for the benefit either of himself or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section.

Shall be guilty of a misdemeanor and punishable by imprisonment for not more than one year or by a fine of not more than one thousand dollars, or both fine and imprisonment.

A typical adaptation of the same law is found in the statute in California.

[1] *Credit Man's Diary and Manual of Commercial Laws*, 1923, p. 99.

Two sections of the Penal Code state the California Penal Law with relation to false financial statements. The first (Section 532) is so broad as to cover the obtaining of money, labor, property, credit, etc., by any fraudulent representations, while the second (Section 532a) applies directly to false financial statements and makes the actual making, benefiting by or reaffirming of the false statement a misdemeanor. The two sections follow:

Section 532.

Obtaining Money, Property, or Labor by False Pretenses.

Every person who knowingly and designedly, by any false or fraudulent representation or pretense, defrauds any other person of money, labor, or property, whether real or personal, or who causes or procures others to report falsely of his wealth or mercantile character, and by thus imposing upon any other person obtains credit, and thereby fraudulently gets possession of money or property, or obtains the labor or service of another, is punishable in the same manner and to the same extent as for larceny of the money or property so obtained.

Section 532a.

Making False Statement of Financial Condition.

Any person—

(1) Who shall knowingly make or cause to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with intent that it shall be relied upon, respecting the financial condition, or means or ability to pay, of himself, or any other person, firm or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring in any form whatsoever, either the delivery of personal property, the payment of cash, the making of loan or credit, the extension of a credit, the execution of a contract of guaranty of suretyship, the discount of an account receivable, or the making, acceptance, discount, sale or indorsement of a bill of exchange, or promissory note, for the benefit of either himself or of such person, firm or corporation; or

(2) (Benefiting by false statement.) Who knowing that a false statement in writing has been made, respecting the financial condition or means or ability to pay, of himself, or such person, firm or corporation in which he is interested, or for whom he is acting, procures upon the faith thereof, for the benefit either of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in the first subdivision of this section; or

(3) (Reaffirming false statement.) Who knowing that a statement in writing has been made, respecting the financial condition or means or ability to pay of himself or such person, firm or corporation, in which he is interested, or for whom he is acting, represents on a later day in writing that such statement theretofore made, if then again made on said day, would be then true, when in fact, said statement if then made would be false, and procured upon the faith thereof, for the benefit either of himself or of such person, firm or corporation either or any of the things of benefit mentioned in the first subdivision of this section; (Penalty) shall be guilty of a misdemeanor, punishable by a fine of not more than five hundred dollars, or by imprisonment in the county jail for not more than six months, or by both such fine and imprisonment.

An indictment under Section 532 must set forth the following facts: "pretense or pretenses which it alleges to be false, and known by defendant to be so made, to person named, for purpose of defrauding him, or another, by means of which he obtains from defrauded person some specific thing of value or sort, included in the statutory inhibition." (*People* v. *Jordan,* 66 Cal. 10.) This section requires that four distinct averments must be proved to constitute the offense described: "(1) There must be intent to defraud; (2) There must be actual fraud committed; (3) False pretenses must be used for purpose of perpetrating the fraud; (4) The fraud must be accomplished by means of false pretenses made use of for purpose; viz., they must be the cause which induces owner to part with his money." *People* v. *Wasservogle,* 77 Cal. 173. The

word "pretense" as here used has the same meaning as "representation."

Section 532a is of comparatively recent origin (1919) and has as yet not been interpreted by the appellate courts of the State. It will be noted that there are three classes of offense:

(1) The making of a false financial statement, with intent that it be relied upon, for purpose of procuring something of value.
(2) The benefiting by such a statement.
(3) The reaffirmance of such a statement.

Penalty.—Under Section 532, where the value of the thing obtained is greater than $200.00 the penalty is one to ten years' imprisonment. If less than the amount the penalty is $500.00 fine or six months' imprisonment, or both. It will be noted that this is identical with the penalty provided in Section 532a.

Section 564 of the Penal Code provides a special penalty for directors or officers of corporations in making false financial statements. The penalty under this section is imprisonment in the penitentiary for not less than six months nor more than five years.

Section 564.

Officers of Corporation Publishing False Reports, Statements, Etc., of its Condition.

Every director, officer, or agent of any corporation or joint-stock association, who knowingly concurs in making, publishing, or posting either generally or privately to the stock-holders or other persons, any written report, exhibit, or statement of its affairs of pecuniary conditions, or book or notice containing any material statement which is false, or any untrue or wilfully or fraudulently exaggerated report, prospectus, account, statement of operations, values, business, profits, expenditures, or prospects, or any other paper or document intended to produce or give, or have

> a tendency to produce or give, the shares of stock in such corporation a greater value or a less apparent or market value than they really possess, or refuses to make any book or post any notice required by law, in the manner required by law, is guilty of a felony.

These penalties are intended to cover all situations where false written statements are used to procure property or credit in any form.

Federal Regulation.—Besides these and similar state laws intended to make the issuance of false statements for the purpose of obtaining credit a crime, there is also a Federal law under which successful prosecution has taken place. In the United States Criminal Code, Section 216, will be found the following:

> U. S. Criminal Code, Section 215:
>
> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretences, representations or promises—shall, for the purpose of executing such scheme or artifice or intention so to do, place or cause to be placed, any letter, postal card, package, writing, circular pamphlet or advertisement, whether addressed to any person within or outside the United States, in any postoffice, or station thereof, or street or other letter box of the United States, or authorized depository for matter, to be sent or delivered by the postoffice establishments of the United States, or shall take or receive any such therefrom, whether mailed within or without the United States, or shall knowingly cause to be delivered, by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such letter, postal card, package, writing, circular pamphlet or advertisements, shall be fined not more than $1,000, or imprisoned not more than five years, or both.

The distinguishing feature in connection with the prosecution under this law is the importance of the means of transmission of the statement from the debtor to the creditor. In

order to prosecute it is necessary to prove that the statement was sent through the mail, hence it is essential that the credit man preserve the envelope in which the statement came and retain both statement and envelope in his files for purposes of record, if such proof should be necessary. A form has been devised by the National Association of Credit Men combining both mailing envelope and statement form itself in such a way that one cannot be preserved without preserving the record of the other. This obviates the necessity of proving that a particular document was received in a particular envelope. This combined statement form and envelope is reproduced in Figures 22a and b in Chapter XII.

References

Brewster, Stanley F. Legal Aspects of Credit, Chaps. I–XXXV.
National Association of Credit Men. Credit Man's Diary, 1925.

CHAPTER XXIII

ADJUSTMENTS, EXTENSIONS, COMPOSITIONS

Adjustments of the Affairs of Insolvent Debtors.—When a debtor has become insolvent, the credit relationship is often strained to the breaking point, with each different creditor attempting to salvage what he can from the organization. It is important that under such conditions everything should be done to conserve the property of the debtor in order that the greatest possible return may come to the creditors. Any kind of litigation or legal warfare is expensive. It is necessary to reduce the cost of handling estates, as well the time necessary for settling, and any method which will aid in securing these ends is desirable, other things being equal. There is a world-wide movement to eliminate economic waste. Every business enterpriser is attempting to arrange his capital assets and combine with them his units of labor in such a way that all the forces of nature may be utilized in the best possible way and the maximum production secured with a minimum of cost. When certain productive units of this economic organization are in trouble, it is essential that as much energy be used in conserving that which has already been created as in planning for the creation of other assets. This is particularly the work of the credit manager.

As receivables fail to liquidate, less cash returns to cash account, and more and more credit or borrowed capital is required, until the business fails to have enough cash to meet its payrolls and other expenses. When further credit or borrowed capital is not to be had, this company must consequently be liquidated for the account of its creditors.

Analysis of the Condition of the Insolvent Debtor.—At this stage the successful, constructive credit manager can often do a world of good, just as the destructive collector can do much harm. The first question that should present itself is, Why is the embarrassed business in the condition that prevents operation? Until that question has been satisfactorily answered, no lasting good can be accomplished. There are many different causes that may bring about the necessity for corrective measures in a business, running the entire gamut of causes for business failures. Some permit rendition of assistance by creditors in keeping the business going, some call for drastic measures. A credit man should never accept the mere word of an embarrassed debtor as to the causes for his condition without thorough investigation and verification. There are debtors who will mislead creditors to the very end as to the real reasons for their inability to pay bills. Such conduct is quite on a par with giving a false financial statement or any other act of dishonesty. On the other hand, there are plenty of debtors who themselves do not know the real cause of their trouble, and require a good business man (which the credit man should be) to diagnose their case and set them straight.

When it is discovered that payment of an account is withheld because of some claim or dispute growing out of misunderstanding, the adjustor for the collection and credit department should immediately endeavor to find out the customer's side of the case. It is pretty certain that payment of the account will not be made until the question is settled. The attitude of the adjustor toward the customer should be receptive, but at the same time should admit no liability until it has been established by facts that there is actual liability on the part of the seller. The attitude of some houses is that "the customer is always right." The advisability of such a

policy is dependent entirely upon the class of trade with which the particular house deals.

The first step wisely taken by creditors in handling the estate of insolvent debtors is to ascertain, as nearly as available means will permit, the true condition of the debtor's affairs, and then arrange for whatever further steps seem to be mutually beneficial. Of course, the first questions to be answered are: How much does the debtor owe, and to whom? How much do his assets amount to? What are they? After these facts have been determined, the next thing to consider is the possibility of getting the debtor out of his financial distress by a continuation of the business. Therefore, it becomes necessary to know what profit his business has been yielding, and if it has been yielding a good profit, to find out the real cause for his present condition. If it is not possible to remedy this condition, it would be worse than useless to continue the business. But, if the cause can be removed, and the business shows a good profit, the thing to do is to put some one in charge as a trustee for the creditors, and continue the business. This trustee may be any one whom the creditors think capable of best serving them—the former proprietor, an efficiency expert, or a committee which, in turn, usually employs a capable manager.

Problem of Securing Additional Working Capital.—One of the perplexing problems is how to secure additional working capital, and frequently capital is not obtainable. It must be sought through one or all of the following channels:

1. Increasing capital by selling more shares in the business.
2. Issuing and selling bonds or notes on security of part or all of the fixed assets of the business.
3. Reducing stocks of materials, if necessary from raw materials to finished products.

4. Reducing accounts receivable by shortening terms of sale, and collection of accounts promptly.
5. Increasing indebtedness by securing longer terms,—often to be safely done by the use of trade acceptances.
6. Making short-term loans by pledging some of the liquid assets (often a dangerous procedure).
7. Securing extension of time for payment of old accounts from creditors, at the same time obtaining credit on usual terms for current purchases.
8. Selling a portion of the fixed assets and reducing production.
9. Reducing all expenses to the minimum consistent with efficient operation.
10. Increasing profits by increasing the price of the product as much as competition or the market will permit.

Possible Methods of Procedure.—After the cause of the trouble has been located and possible means of securing new working capital have been considered, five methods of procedure are possible in the handling of the situation. The cause usually dictates the one most appropriate to the immediate needs. These five methods are:

1. Extension of time, with or without security.
2. Composition settlement.
3. Assignment with or without release.
4. Appointment of a receiver.
5. Bankruptcy—voluntary or involuntary. (Remedies 4 and 5 will be discussed in Chapter XXIV.)

The peaceable and equitable adjustment of all disputes and controversies is always preferable to any other method. This applies to honest debtors where they may become temporarily embarrassed or insolvent. It is the peaceable, friendly adjustment between debtor and creditors that permits the best results finally. This kind of settlement, as compared with litigation, makes possible a saving of time and expense and almost in-

variably produces larger amounts ultimately for the creditors, whether the business is continued or discontinued.

The Extension.—The extension is the outcome of an agreement between the debtor and his creditor, in which the debtor has sought an extension of time in which to meet his obligations. It is quite true that good business men are often in credit difficulties. Certain business circumstances, or it may be one false step on the part of the debtor, may put him in a position where an extension is absolutely necessary if he is to avoid bankruptcy. Many considerations are, of course, involved. It must always be certain that the debtor is honest, that his character is unimpeachable; the creditors must feel that he can be relied upon to protect their individual interests; they must be sure that in the business itself is found an inherent strength which is sufficient to allow the proprietor to relieve himself of the difficulties of the present, and that he, individually, has the capacity to make a paying business out of the organization which he represents.

Perhaps the most serious problem presenting itself to the collection department is this one of the extension of time for payment of accounts. Some debtors need extensions, but it is evident that many ask for extensions simply because they discover they can often get them by pitting sales and credit managers against one another on terms and credit privileges. An extension should not be granted unless there is need for it and then only after that need has been clearly manifested to the creditor, and the extension justified by the facts. The creditors will want to examine the reason for the debtor's embarrassment; they will want to see whether or not the causes of his troubles are such that they can be removed; they may even find it necessary and desirable to send him more goods, in order that he may continue business and "pay out."

It has been suggested that a condition of great benefit would

arise if every creditor immediately notified the Credit Clearance Bureau of the Credit Men's Association nearest to the debtor, or Dun's and Bradstreet's, of any extensions granted. If this were done religiously, it would prevent many a business failure and loss. Instead of credit men giving away "secrets" of their customers, they would be rendering commerce a real service.

The Extension Agreement.—When it is necessary for a debtor to seek a general extension from all of his creditors, great care must be exercised to see that some of these creditors do not get an advantage over other creditors. For that reason an agreement should, in such cases of general extensions, be carefully drawn and accepted by all parties. Under agreements for extensions, provisions should be made for creditors to receive interest on their accounts from the date they became due to the time of final payment. If notes are taken, or for that matter, if a contract is entered into, care should be taken not to violate the statutes of any state pertaining to interest and usury. What might be a legal rate of interest in the state in which the document is prepared, might be in excess of the interest rate provided by statute in the state where the debtor is asked to execute it, and that fact might cause the forfeiture of the entire amount of interest.

The following is a copy of an actual extension agreement:

THIS AGREEMENT made this...............of................A. D. 19... between a manufacturing concern, hereinafter called "Company"; Banking Company for and on behalf of itself and such others as may join with them the "Manager," the Finance Corporation, hereinafter called the "Financier," and such of the Creditors of the "Company" whose signatures appear on this agreement, or any counterpart thereof,

WITNESSETH:

IN CONSIDERATION of the undertaking of the "Manager" to procure either from its own resources or from the discount or re-discount of such obligations of the "Company" as may be available therefor, the advances of such moneys as the "Company" may require from time to time as work-

ing capital or otherwise, during the period next ensuing and ending ....19..., the amount thereof to be determined by the "Manager" and to be advanced for such period as in the judgment and discretion of the "Manager" and the "Financier" shall be necessary and expedient.

AND IN FURTHER CONSIDERATION of the "Company" procuring the aid and assistance of the "Financier" in the executive management, direction, operation and possible re-organization of the "Company" upon such terms as the "Manager," "Financier" and the "Company" may determine, and in consideration of the mutual covenants and agreements herein contained, the undersigned being creditors of the "Company" in the amount set opposite their respective signatures, do agree to and with them and with each other to extend the time of payment of their respective claims until ....19..., and upon agreement with the "Manager" for a further period of not exceeding six months thereafter.

IT BEING DISTINCTLY UNDERSTOOD AND AGREED, that all advances made by the "Manager" to the "Company" shall be paid in full with legal interest thereon, before any payment shall be made upon any of the claims of those creditors whose signatures appear hereon.

And in the event of liquidation or dissolution, voluntary or involuntary, by insolvency or bankruptcy proceedings, or otherwise, such advances made by the "Manager" shall be considered as part of the cost of preserving the property of the "Company" and shall be entitled to priority of payment, before any distribution or dividend shall have been declared or paid upon any of said claims of said creditors.

IT BEING FURTHER DISTINCTLY UNDERSTOOD AND AGREED, that in the event of such insolvency or bankruptcy proceedings, all claims of said "Manager" for such advances and all claims of creditors shall become immediately due and payable.

This agreement shall become effective when creditors whose claims aggregate the sum of $500,000 shall have signed the same.

IN WITNESS WHEREOF, the parties hereto have severally hereunto placed their hand and seals, the day year first above written.

WITNESS:

....
....
....

Composition Settlements.—The extension of credit to the debtor does not always meet the need. When it is quite likely

that an actual deficit cannot be made up (although there is still prospect for a continuation of the business if the debtor could be relieved of some of the accumulated debt), it may be desirable to arrange for another plan of procedure. This is often called the common law, or composition settlement. Here the debtor and several of his creditors agree on the basis of each other's promise to release the debtor from the entire debt on receiving partial payment from him. Debtors sometimes misuse this means of settlement and ask for composition settlements when they should not do so. The hope in the minds of those who agree to such a settlement is that the assets will become productive and that continued business will be enjoyed by those who have agreed to this settlement and enabled the man to continue without disaster. It is absolutely essential, of course, that there be no question as to the honesty and integrity of the man and that there be hope that he may make a profit from year to year.

One of the difficult tasks in composition settlements and assignments is to secure the consent of all the creditors. The creditors are notified formally that a meeting has been held and they are informed of the decision reached by those present. Creditors are then asked to sign an agreement which will permit putting this decision into force. Such signatures are usually secured with little difficulty in local circles, but creditors removed some distance from the scene of action are apt to view the situation differently and cause more or less trouble before the plan is put into action. It is a common occurrence that approximately two-thirds of the debtors will accept the agreement, the other one-third holding out for settlement in full or for some preference over the other creditors. Further arbitration takes time and during this time the creditors originally agreeing to the composition become dissatisfied. They argue that they agreed to accept the composition with the understanding that they were to receive their pro-rata at

once—overlooking the fact that consent of all creditors is usually necessary in such settlements. Thus composition settlements are at all times difficult, and, if there are a large number of creditors, almost impossible.

Adjustment Bureaus.—To keep debtors out of bankruptcy is the real aim of all good credit men; bankruptcy should be the last resort. The debtor is injured by the formal declaration of bankruptcy because he feels the shame of failure and the futility of his efforts; he loses faith in his ability, and to a certain extent his incentive for future activity is blunted. The particular industry with which he is connected suffers, in that the faith of other merchants is shaken and the structure is weakened by the wreck of even a minor house. The creditors themselves lose, by the declaration of bankruptcy, a certain portion of their accounts receivable. The dollars and cents may not be the only loss. There is an even greater loss in the tightening effect on the mind of the credit man. The failure has made him more careful and this condition, while in itself desired, may be carried so far as to restrict business to a degree that chokes it and prevents legitimate expansion. The creditors feel, besides, that bankruptcy offers too open a way for a debtor to escape his just debts and in the escape they feel a collapse of the credit structure. All credit men, however, believe in the efficacy of the Bankruptcy Act for many situations.

The loss to the community through bankruptcy is, in all probability, the greatest loss. By the community is meant the entire business world, the bankers, the consumer, and everybody. To the consumer who buys cheaply at a bankrupt sale, that sale may appear to be a species of good fortune rather than an injury, but somewhere along the line that failure means a reduction in production, and a reduced production means less product for some other consumers.

The adjustment bureau is an organized means of preventing bankruptcy. Adjustment involves a meeting of the creditors before the financial death of an enterprise, while bankruptcy involves a meeting of the creditors after the financial death of the enterprise. When a creditor is notified that a meeting is to be held in connection with the adjustment bureau, all creditors know that nothing is to be gained by precipitate action, and thus they meet in a free spirit of cooperation. The fundamental aims of the adjustment bureau have been set forth as follows:

1. To investigate, upon request, the affairs of a debtor reported to be insolvent and to adjust the estate when possible without court proceedings.
2. To secure capable and efficient receivers, appraisers or trustees, when court proceedings are found to be necessary.
3. To secure quick adjustment of all honest failures at the minimum cost and with the maximum dividend to creditors.
4. To facilitate and economically secure liquidation when upon investigation it is found to be to the best interests of all.
5. To influence concentrated action by the creditors for the benefit of all.
6. To assist creditors to acquire for their own use the estate of failing or insolvent debtors when mutually agreed upon.
7. To prosecute or assist in the prosecution of the guilty party or parties when investigation discloses fraud or the intent to defraud.

Adjustment bureaus may be organized either in the form of corporations in which the stockholders are limited to the members of a local association or as a corporation without the stockholding feature, with the management in the hands of an attorney employed on a fee basis, or in the form of committees

with each committee handling the cases on their own merits. As to whether or not adjustment bureaus should collect accounts, entire agreement has not yet been reached, although a general resolution has been passed by the National Association of Credit Men to the effect that it would be wiser for adjustment bureaus to eliminate the collection of accounts. The adjustment bureaus are organized to run at cost. Disputes between bureaus and members or between one bureau and another are arbitrated by a national committee.

Assignments.—The decision arrived at through the meeting of the creditors either through the agency of an adjustment bureau, or without it, may be to arrange for an assignment which is a transfer of property in trust for the benefit of creditors. In that case the papers are generally assigned at once and a representative of the creditors, who is accustomed to such work, is sent to take possession of the store and assets, to take an inventory, to collect the accounts, to see that the place is kept insured, and in every other way to operate the business as if it were his own. When a final report is made to the creditors' committee, a decision is made as to whether the business is to be sold, closed up, the stock moved into a warehouse, or the business is to be continued.

If the business is to be sold as a going concern, or is to be closed up and sold after inventory, it may be sold through a professional auctioneer or advertised from day to day in the daily newspapers under the head of "Business Chances" or "Business Opportunities." Often the assignee demands cash payment on the sale of the assets and occasionally he has to accept the note of the buyer on the vote of the committee. The adjuster who is in charge of the case first takes a complete inventory and cleans up the stock in the entire store, giving the assignee a list of all the accounts receivable, as well as a full list of the creditors. The adjuster must also assure all small

or local creditors that the assignment is for the mutual benefit of all and must convince them that they should not attach any of the property.

Advantages of Amicable Settlement.—The advantages of settlement of accounts outside of the courts are many. Resort to the courts is costly at best and usually affords little opportunity for taking advantage of economic conditions in the liquidation of a business. It is usually more difficult to convert merchandise into cash and to collect receivables, when an estate once reaches receivers' hands or bankruptcy. As a matter of fact, where some plan other than bankruptcy is followed, the percentage of return is usually far in excess of what could be hoped for under court proceedings. Many businesses have, in this way, been placed on a solid basis, paying 100 cents on the dollar to creditors, and have continued thereafter as profitable customers. Even when a business that is granted an extension is not able to recover itself, and is compelled later on to liquidate, the creditors usually receive a greater amount than when litigation is invoked in the first place. Another thing not to be overlooked is the profit made on subsequent sales under an extension agreement that would not otherwise have accrued in that business.

The debtor is also usually benefited by the amicable settlement. If this kind of settlement were not possible, it would be necessary to attach or throw into bankruptcy the business of nearly every unsuccessful business man. This would mean that every business man who happened to be unfortunate enough to lack some business qualities, but yet was honest, would be subjected to the unsavory results of these legal remedies. A little time and patience usually put a great many of these unfortunates back on their feet, as producing factors and of benefit to society. The credit man at this stage of his work has it within his grasp to make or mar many a life. In decid-

ing the action to be taken in any such case, due thought should also be given to the moral responsibility that attaches, and not merely to what might be most expedient legally.

References

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CHAPTER XXIV

RECEIVERSHIP AND BANKRUPTCY

Development of Uniform Legislation.—By means of the legislation provided in connection with Receivership and Bankruptcy it is possible to protect the interest of debtor and creditor alike. The theory upon which bankruptcy law is based is pro rata equality for each creditor of a bankrupt estate. Legislation in the United States has sought to prevent one creditor from securing advantage over other creditors in an estate. This is qualified, of course, as to secured and unsecured creditors. Another prime factor in bankruptcy legislation in the United States has been the discharge of honest and deserving citizens from a burden of debt incurred through circumstances at least partially beyond their control. This object is often best accomplished by settlements outside of the Bankruptcy Court through Adjustment Bureaus in recent years established in our principal cities by the National Association of Credit Men.

History is replete with incidents indicating the severe penalties to which a delinquent debtor might be subjected on the part of his creditors. Early Roman Law provided death or sale into slavery as a punishment for the man who could not pay his bills. In England at the time of the colonial period, it was possible to have a debtor put to death. The English, however, were the first people who made bankruptcy law definitely a part of their legal code. In the operation of common law procedure there was great inequality in liquidating a debtor's estate. The diligent creditor managed to secure execution ahead of others, oftentimes taking all of the debtor's property and leaving nothing for others. It was such condi-

tions that brought about the enactment of England's first bankruptcy law in 1542. This law applied only to merchants and traders. It was directed against fraudulent debtors, and provided no release of any kind, not even from imprisonment. It did provide for the seizure and pro rata distribution of debtor's property among creditors. In 1705 a law was enacted known as Queen Anne's Act, which provided release for the debtor from that portion of his debts remaining unpaid after pro rata distribution of his property.

The earliest legislative expression on the subject of bankruptcy in the United States seems to have been in 1787, when delegates assembled in the Federal Constitutional Convention, drafted into the Constitution a provision giving Congress power "To establish . . . uniform laws on the subject of bankruptcies throughout the United States."

Bankruptcy legislation is based on Art. 1, Sec. 8, of the Constitution of the United States as referred to above. Though provided for throughout a period of more than a century and a quarter, actual legislation has not been in force for much more than a fourth of that time.

The United States Bankruptcy Laws of 1800, 1841, and 1867, were repealed within a few years of their passage. The law of 1898, with amendments, remains in effect at the present time. At various times the states also have enacted laws on this subject, but the general rule of interpretation is that such portions of a state law as are in conflict with the federal statute are abrogated.

Nature of Receiverships.—Receiverships are created by courts in equity on the theory that the remedy to be obtained in the law courts is not adequate. When the total assets of a debtor exceed his total liabilities, but he lacks cash to meet maturing bills, he may ask the courts to protect his property from a forced sale at the hands of his creditors, by asking for

the appointment of a receiver. Often creditors apply for a receiver to protect property pending settlement of litigation. Selection of the receiver is left to the discretion of the court, but as it is very desirable that the receiver appointed should act upon his own responsibility it is necessary that he be familiar with the business. Very often the debtor is required to make an assignment of all property to the receiver, thus placing it beyond the reach of all creditors who may have judgments against it.

When petitions in involuntary bankruptcy cases are filed, a petition for the appointment of a *Receiver* is usually filed at the same time. In these cases a Receiver is appointed by the District Judge, with or without the consent of the alleged bankrupt. The Judge at his discretion may give the receiver authority to continue the business. In the absence of such authority the receiver acts merely as custodian of the bankrupt's property. He remains in control until the first meeting of creditors, which is supposed to be called not less than ten nor more than thirty days after the debtor has been adjudicated a bankrupt.

Conditions of Receivership.—In order to secure the appointment of a receiver it is necessary to show a legal right to the property, a lien on the property, or that the applicant is entitled to payment from a particular fund or portion of the property. It is also possible to secure the appointment of a receiver by showing fraudulent possession of the property or that the property itself is in danger of loss from the neglect, waste, misconduct or insolvency of the holder. If there is no person competent to manage the property under litigation, if for any reason it is not deemed proper that any of the litigating parties should control the property, if the person holding the property occupies a position of trust relation and is violating his fiduciary duties, and if after a judgment is given, the

ordinary processes of law cannot carry the judgment or decree into effect, a receiver will be appointed.[1]

Powers and Duties of a Receiver.—It is intended that the receiver should carry on his activities as an officer of the court and consequently he is expected to ask and receive instructions from the court as to his duties, rather than exercise large discretionary powers on his own part.

The receiver is expected to take charge of and account for all property included in the receivership. The receiver can get favorable action on the part of the court to receive possession of all property indicated. He must usually give bond for the faithful performance of his duties, and while primarily responsible to the courts, he is not excused from negligence in his relation to third parties. If any injury or loss occurs in relation to the property entrusted to him, through his own fraud or negligence, he is liable.

The tenure of the receiver is subject to the discretion of the court on the basis of the necessity and the character of services rendered. He cannot resign at will unless the interests of the owner of the property are served by such a change. As an Equity Receiver is appointed for the purpose of establishing what amounts to a moratorium on behalf of the debtor and to preserve the estate for creditors, the receiver as a rule continues the business, often with the cooperation of creditors or a creditors' committee, and eventually either liquidates the business or returns it to the debtor. The fees of the receiver and his attorney are also in the discretion of the court.

Principles of Bankruptcy Legislation.—Bankruptcy legislation of the present day has changed in the same way as the attitude of business men toward one another has changed. There is a spirit of cooperation which was not present at an

[1] Tardy's *Smith on Receivers*, p. 23.

earlier date. Necessity has been to a certain extent responsible for this changed attitude and the big business enterprise is consequently made more successful through the use of credit. It is absolutely essential at this day that business risks should be taken. Many men in business succeed and many fail. In a competitive economic organization such as the one in which we live, we believe that all those who manage to make their enterprises a financial success render such important service to the community that the good resulting from their success more than compensates for the loss in connection with those who fail. If this is the business attitude generally accepted by our social and legal organization, then it would be indeed unfair to consider an honest man who has failed a criminal. If there has been an understanding that possible returns are commensurate with the risk involved, the man who has loaned his money should have no claim in equity, and society should not feel that it is necessary to punish a debtor who honestly surrenders his property for the benefit of creditors, even though there might be realized only 50 cents on the dollar.

There is another aspect to the philosophy underlying bankruptcy legislation. It is highly important to economic society to give an honest debtor an opportunity to make a new start and thus become a productive economic factor, rather than have him become a charge upon society. In accordance with this change of spirit and policy which took place in the nineteenth century, commercial interdependence has developed the conception of the partnership relations between debtor and creditor. Business practice has even gone further, as has been noted in the discussion of adjustment bureaus and cooperative arrangements for the settlement of questions involved in the adjustment of failing but honest debtors.

The purposes of bankruptcy proceedings may be summarized as follows:

For the Benefit of Creditors

To bring about a distribution of the assets of the bankrupt on an equitable basis among creditors.

To locate by court action all the assets of a bankrupt.

To provide uniform administration of insolvent estates.

For the Benefit of the Debtor

To discharge the honest debtor and give him an opportunity to again become productive in an economic way.

For the Benefit of the Business Community

To provide an orderly method of settlement of debt and at the same time benefit both creditor and debtor.

If these purposes can be achieved, it is readily seen how it is possible to build up mutual confidence between debtor and creditor, and to secure the cooperation of creditors, thus tending to eliminate the tendency to lawsuits. Insolvency had always meant lawsuits. Suspicion of failure led immediately to levy of attachment of execution with all creditors joining in a mad race for preference.

The progression of actual bankruptcy proceedings may be briefly summarized as follows:

1. Filing of petition, with schedule of assets and liabilities, in the Federal District Court.
2. Adjudication of petition, and turning case over to the referee for administration.
3. Notification of creditors of action taken.
4. Filing proofs of claims by creditors with referee.
5. Calling meeting of creditors by referee.
6. Election of Trustee by creditors.
7. Examination of Bankrupt by creditors.
8. Liquidation of estate by Trustee and prorating proceeds among creditors.
9. Report of Trustee to referee for approval.
10. Discharge of bankrupt, if report is approved by the court.

Kinds of Bankruptcy.—Bankruptcies are of two kinds, voluntary and involuntary. If a person is declared to be a bankrupt on his own initiative it is referred to as voluntary bankruptcy, and if on the petition of his creditors, it is referred to as involuntary. Petitions in bankruptcy may be filed in relation to any one excepting banking, insurance, railroad and municipal corporations. Institutions of this type have recourse only to a court of equity for the appointment of a receiver. If other persons than those mentioned wish to secure appointment of a receiver, an action in equity may also be used, but if other creditors institute bankruptcy proceedings in a federal district court, the equity action fails. Individual circumstances must decide the wisdom of the debtor's own petition to be adjudged a bankrupt. It is sometimes better to anticipate the inevitable end. In many cases an apparently involuntary bankruptcy is in reality voluntary, for the debtor has invited his creditors in and given them the facts, showing his inability to pay his debts, even with generous extensions. The debtor has perhaps suggested that his creditors file petition and has acknowledged his condition in writing.

Creditors and debtors alike must be on the lookout for unscrupulous attorneys who sometimes get control of the property and proceed to bleed the bankrupt estate for their own interests. This phase of bankruptcy practice has become a serious problem for legitimate business. The National Association of Credit Men, in its 1924 issue of the "Credit Man's Diary and Manual of Commercial Laws," has issued the following warning to credit men:

> WARNING—A warning must be sounded against accepting the offers of unknown attorneys to file the proof of claim and power of attorney in a given case without cost to the creditor. There is no necessity for employing an attorney for the purpose of filing a claim. Forms for preparing proofs of claim may be purchased at any legal stationers and are set forth in this volume, pages 38-41.

Attorneys who offer to perform this service without charge have almost invariably an ulterior motive, namely, to control the majority in number and amount of the claims, so that they are thereby enabled to dictate the choice of a Trustee, or to force through a composition settlement. Too often such attorneys are on intimate terms with the attorneys for the bankrupt and proper representation of the creditors' interests is not likely to result from employing their services. Unless a creditor selects with care a representative to vote his claim, it is better that the proof of claim should be filed direct with the Referee and power of attorney given to no one. It is better yet, however, for the creditor to have his own representative at all the meetings where Trustees are to be elected, sales of the bankrupt's property ordered, or compositions voted upon.

It must be remembered that loss is inevitable when insolvency occurs, but a careful administration and a painstaking interest in each case will serve to minimize losses and increase dividends. The small dividends paid by many bankrupt estates can be accounted for wholly through lack of interest and attention on the part of the creditors. Failure to attend creditor's meetings or to be properly represented; failure to insist upon the statutory right of examining the bankrupt before he shall offer terms of composition to his creditors; unwillingness to expend the time and energy necessary to secure co-operative action upon the part of fellow creditors; and the easy but pernicious habit of filing and acting through the first collection agency asking the privilege and then forgetting the matter, are undoubtedly the chief causes of dissatisfaction with the Bankruptcy Act as it stands today.

Ten Points on Bankruptcy:

1. The bankruptcy court is a CREDITORS' COURT, and the credit man who fails to interest himself in its administration is costing his house money.

2. For every crooked bankrupt, there are likely to be two crooked lawyers, one representing the bankrupt, the other soliciting your claim—in the interest of a crooked settlement.

3. Creditors who want honest administration must wake up their sleeping brothers. Solicit their claims yourself. Don't leave it to someone who may be in collusion with the bankrupt.

4. Beware of compositions. You have a right to the facts and figures. Don't sign until you know.

5. A bankrupt who refuses to answer questions has something to conceal.

6. Know who filed the petition. Sometimes the "three creditors" (so called) are dummies representing the bankrupt.

7. A superficial examination of the bankrupt is worse than none. It is often used to whitewash a black record.

8. Examine the schedules and beware of bogus benefactors. Rich and benevolent relatives file large claims for small advances.

9. Receivers with good intentions have dissipated many an estate. Elect a business man trustee and see that he does his job, and elect him early.

10. Take nothing for granted.

The Acts of Bankruptcy.—Chap. III, Sec. 4, of the Bankruptcy Act indicates those persons who may become bankrupts. As stated above, any persons, except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this Act as a voluntary bankrupt.

Involuntary bankruptcy can take place if the debtor owes one thousand dollars or over and it can be proved that he has committed one of the five acts of bankruptcy. The Acts of Bankruptcy are stated in Chap. III, Sec. 3 as having:

(1) conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them; or (2) transferred while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or (3) suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or final disposition of any property affected by such preference vacated or discharged such preference; or (4) made a general assignment for the benefit of his creditors, or, being insolvent, applied for a receiver or trustee for his

property or because of insolvency a receiver or trustee has been put in charge of his property under the laws of a State, of a Territory, or of the United States; or (5) admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.

The petition may be filed any time against a person who is insolvent and who has committed an act of bankruptcy, within four months after the commission of such act. Insolvency implies that the debtor's resources at a fair valuation are less than his existing liabilities.

The Presentation and Adjudication.—After a petition for involuntary bankruptcy has been filed, service with a writ of subpœna is made upon the person named as defendant in the same manner as a suit in equity is begun in a United States Court. If personal service cannot take place, the matter may be handled by publication. The bankrupt or any of his creditors may appear and controvert the alleged facts, and the judge may adjudicate or dismiss the petition. The person against whom the petition is filed is entitled to a trial by jury in respect to the question of his insolvency. In the case of voluntary bankruptcy, the petition is filed and the court decides whether or not the petition is to be granted.

The petition is prepared on a prescribed legal form, providing for the presentation of facts concerning the following:

1. Name of the judge and location of the particular court petitioned.
2. Statement of location of the business.
3. Statement of the situation:
   (a) If the bankruptcy is voluntary, that the petitioner owes debts which he is unable to pay in full, and that he is willing to surrender all his property to his creditors.

(b) If the bankruptcy is involuntary:
   (1) That the debtor owes debts to the amount of \$1,000, and is not a wage earner, nor chiefly engaged in farming,
   (2) That the petitioners are creditors of said debtor and have provable claims in excess of \$500,
   (3) That the debtor is insolvent and within the past four months committed an act of bankruptcy, stating in detail of what the act consisted.

4. Statement of all creditors who are to be paid in full, or to whom priority is secured by law.
5. Statement of creditors holding securities.
6. Creditors whose claims are unsecured.
7. Statement of liabilities.
8. Statement of assets.
9. Statement of property claimed as exempt.
10. List of documents pertaining to the business.
11. Oath in verification of presentation made.

Arranging for Liquidation.—All the bankrupt estates within certain territories are supervised by officers of the federal court known as referees. As soon as an insolvent has been adjudged a bankrupt, the referee takes charge of the estate, acts as the presiding officer, and allows or disallows claims of creditors. The jurisdiction of referees is stated as follows, in Chap. V, Sec. 38, of the United States Bankruptcy Laws:

> Referees respectively are hereby invested, subject always to a review by the judge within the limits of their districts as established from time to time, with jurisdiction to (1) consider all petitions referred to them by the clerks and make the adjudications or dismiss the petitions; (2) exercise the powers vested in courts of bankruptcy for the administering of oaths to and the examination of persons as witnesses and for requiring the pro-

duction of documents in proceedings before them, except the power of commitment; (3) exercise the powers of the judge for the taking possession and releasing of the property of the bankrupt in the event of the issuance by the clerk of a certificate showing the absence of a judge from the judicial district, or the division of the district, or his sickness, or inability to act; (4) perform such part of the duties, except as to questions arising out of the applications of bankrupts for compositions or discharges, as are by this act conferred on courts of bankruptcy and as shall be prescribed by rules or orders of the courts of bankruptcy of their respective districts, except as herein otherwise provided; and (5) upon the application of the trustee during the examination of the bankrupts, or other proceedings, authorize the employment of stenographers at the expense of the estates at a compensation not to exceed ten cents per folio for reporting and transcribing the proceedings.

The trustee is the representative of the creditors as contrasted with the referee, who is the representative of the court. He is elected by the creditors, and in being properly bonded becomes vested with all the property of the bankrupt. The trustee proceeds to dispose of the bankrupt estate to the greatest advantage and best interests of all the creditors. His duties are defined in Chap. V, Sec. 47, as follows:

a. Trustees shall respectively (1) account for and pay over to the estates under their control all interests received by them upon property of such estates; (2) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estate as expeditiously as is compatible with the best interests of the parties in interest; and such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied; (3) deposit all money received by them in one of the designated depositories; (4) disburse money only by check or draft on the depositories in

which it has been deposited; (5) furnish such information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; (6) keep regular accounts showing all amounts received and from what sources and all amounts expended and on what accounts; (7) lay before the final meeting of the creditors detailed statements of the administration of the estate; (8) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; (9) pay dividends within ten days after they are declared by the referees; (10) report to the courts, in writing, the condition of the estates and the amounts of money on hand, and such other details as may be required by the courts, within the first month after their appointment and every two months thereafter, unless otherwise ordered by the courts; and (11) set apart the bankrupt's exemptions and report the items and estimated value thereof to the court as soon as practicable after their appointment.

b. Whenever three trustees have been appointed for an estate, the concurrence of at least two of them shall be necessary to the validity of their every act concerning the administration of the estate.

c. The trustee shall, within thirty days after the adjudication, file a certified copy of the decree of adjudication in the office where conveyances of real estate are recorded in every county where the bankrupt owns real estate not exempt from execution, and pay the fee for such filing, and he shall receive a compensation of fifty cents for each copy so filed, which, together with the filing fee, shall be paid out of the estate of the bankrupt as a part of the cost and disbursements of the proceedings.

Creditors' Proceedings.—The time and place of creditors' meetings is regulated by statute. The creditors are expected to take such action at each meeting as may be pertinent or necessary to the promotion of the best interests of the estate and the enforcement of this act. None but creditors with allowed claims can participate in the selection of a trustee. A prescribed form is used for filing claims setting forth under oath that the sum claimed is justly owing and indicating con-

sideration, securities held, and payments made. Claims not proved within a year subsequent to adjudication are generally denied.

The bankrupt is subject to examination by the creditors in accordance with Chapter III, Sec. 7, which reads as follows:

> The bankrupt shall (1) attend the first meeting of his creditors, if directed by the court or a judge thereof to do so, and the hearing upon his application for a discharge, if filed; (2) comply with all lawful orders of the court; (3) examine the correctness of all proofs of claims filed against his estate; (4) execute and deliver such papers as shall be ordered by the court; (5) execute to his trustee transfers of all his property in foreign countries; (6) immediately inform his trustee of any attempt, by his creditors or other persons, to evade the provisions of this act, coming to his knowledge; (7) in case of any person having to his knowledge proved a false claim against his estate, disclose that fact immediately to his trustee; (8) prepare, make oath to, and file in court within ten days, unless further time is granted, after the adjudication, if an involuntary bankrupt, and with the petition if a voluntary bankrupt, a schedule of his property, showing the amount and kind of property, the location thereof, its money value in detail, and a list of his creditors, showing their residences, if known, if unknown, that fact to be stated, the amounts due each of them, the consideration thereof, the security held by them, if any, and a claim for such exemptions as he may be entitled to, all in triplicate, one copy of each for the clerk, and one for the referee, and one for the trustee; and (9) when present at the first meeting of his creditors, and at such other times as the court shall order, submit to an examination concerning the conducting of his business, the cause of his bankruptcy, his dealings with his creditors and other persons, the amount, kind, and whereabouts of his property, and, in addition, all matters which may affect the administration and settlement of his estate; but no testimony given by him shall be offered in evidence against him in any criminal proceeding.
>
> Provided, However, That he shall not be required to attend a meeting of his creditors, or at or for an examination at a place more than one hundred and fifty miles distant from his home or principal place of business, or to examine claims except when

presented to him, unless ordered by the court, or a judge thereof, for cause shown, and the bankrupt shall be paid his actual expenses from the estate when examined or required to attend at any place other than the city, town, or village of his residence.

Liquidation of the Estate.—The primary purpose of the act has been stated to be the equitable distribution of the property owned by the bankrupt. In accordance with the act, this is interpreted to mean property owned during the preceding four months. The trustee ought to recover every payment made to creditors within four months, because such a payment constitutes a preference within the meaning of the act. It does not, however, constitute a preference unless the creditors who received the payment had reasonable cause to believe the debtor was insolvent at the time.

Certain debts are given priority over the claims of general creditors. Chapter VII, Sec. 64, states them to be as follows:

> a. The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.
>
> b. The debts to have priority, except as herein provided, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases, and, where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expenses of such recovery; (3) the cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of

attorneys employed, to the petitioning creditors in involuntary cases, to the bankrupt in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary cases, as the court may allow; (4) wages due to workmen, clerks, traveling or city salesmen, or servants which have been earned within three months before the date of the commencement of proceedings, not to exceed three hundred dollars to each claimant; and (5) debts owing to any person who by the laws of the States or the United States is entitled to priority.

c. In the event of the confirmation of a composition being set aside, or a discharge revoked, the property acquired by the bankrupt in addition to his estate at the time the composition was confirmed or the adjudication was made shall be applied to the payment in full of the claims of creditors for property sold to him on credit, in good faith, while such composition or discharge was in force, and the residue, if any, shall be applied to the payment of the debts which were owing at the time of the adjudication.

After prior claims have been paid dividends may be declared in accordance with Chapter VII, Secs. 65 and 66, which read as follows:

a. Dividends of an equal per centum shall be declared and paid on all alowed claims, except such as have priority or are secured.

b. The first dividend shall be declared within thirty days after the adjudication, if the money of the estate in excess of the amount necessary to pay the debts which have priority and such claims as have not been, but probably will be allowed equals five per centum or more of such allowed claims. Dividends subsequent to the first shall be declared upon like terms as the first and as often as the amount shall equal ten per centum or more and upon closing the estate. Dividends may be declared oftener and in smaller proportions if the judge shall so order: Provided, That the first dividend shall not include more than fifty per centum of the money of the estate in excess of the amount necessary to pay the debts which have priority and such claims as probably will be allowed; and provided further, That the final dividend shall not be declared within three months after the first dividend shall be declared.

c. The rights of creditors who have received dividends, or in

whose favor final dividends have been declared shall not be affected by the proof and allowance of claims subsequent to the date of such payment or declarations of dividends; but the creditors proving and securing the allowance of such claims shall be paid dividends equal in amount of those already received by the other creditors if the estate equals so much before such other creditors are paid any further dividends.

d. Whenever a person shall have been adjudged a bankrupt by a court without the United States and also by a court of bankruptcy, creditors residing within the United States shall first be paid a dividend equal to that received in the court without the United States by other creditors before creditors who have received a dividend in such court shall be paid any amounts.

e. A claimant shall not be entitled to collect from a bankrupt estate any greater amount than shall accrue pursuant to the provisions of this act.

Section 66

a. Dividends which remain unclaimed for six months after the final dividend has been declared shall be paid by the trustee into court.

b. Dividends remaining unclaimed for one year shall, under the direction of the court, be distributed to the creditors whose claims have been allowed but not paid in full, and after such claims have been paid in full the balance shall be paid to the bankrupt: Provided, That in case unclaimed dividends belong to minors such minors may have one year after arriving at majority to claim such dividends.

Composition Settlements.—Sometimes the bankrupt wishes to regain possession of the business. His object is either to continue the business or to dispose of it at a profit as a going concern. He may do so under certain conditions as provided in the act. He may either before or after adjudication offer terms of composition, and if these are accepted by the majority in amount of claims filed, an agreement to that effect can be made binding by the court upon all. As set forth in Chapter III, Sec. 12, paragraph (d):

d. The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors; (2) the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge; and (3) the offer and its acceptance are in good faith and have not been made or procured except as herein provided, or by any means, promises, or acts herein forbidden.

The Discharge of the Bankrupt.—One of the purposes of bankruptcy legislation is to return to economic society a free, unencumbered, productive agent. If there has been a proper accounting of assets and liabilities, and the division of assets has taken place without interference, the bankrupt is entitled to a discharge. This gives legal relief from the obligation to pay debts in full, but does not relieve the moral obligation to pay if able, which many a bankrupt does at a later date.

Chapter III, Sec. 14, paragraph (b), provides that discharges are to be granted unless applicant has:

"(1) committed an offense punishable by imprisonment as herein provided; or

(2) with intent to conceal his financial condition, destroyed, concealed, or failed to keep books of account or records from which such condition might be ascertained; or

(3) obtained money or property on credit upon a materially false statement in writing, made by him to any person or his representative for the purpose of obtaining credit from such person; or

(4) at any time subsequent to the first day of the four months immediately preceding the filing of the petition transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property, with intent to hinder, delay, or defraud his creditors; or

(5) in voluntary proceedings been granted a discharge in bankruptcy within six years; or

(6) in the course of the proceedings in bankruptcy refused to obey any lawful order of or to answer any material question approved by the court: Provided, That a trustee

> shall not interpose objections to a bankrupt's discharge until he shall be authorized so to do at a meeting of creditors called for that purpose."

Undischarged Debts.—The Bankruptcy Act specifically cites certain debts from which the bankrupt is not discharged after having passed through bankruptcy. Chap. III, Sec. 17, reads as follows:

> a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as (1) are due as a tax levied by the United States, the State, county, district, or municipality in which he resides; (2) are liabilities for obtaining property by false pretences or false representations, or for breach of promise of marriage or wilful and malicious injuries to the person or property of another; or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; or (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity, or (5) are for wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of commencement of the proceedings in bankruptcy; or (6) are due for monies of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment.

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CHAPTER XXV

SPECIAL PROTECTION FOR THE CREDIT RELATION

Fire Insurance.—In addition to desiring that a customer shall be a person of good character, with sufficient capacity to conduct the business, and also with sufficient capital required for its prosecution, the credit man finds it necessary to assure himself against the possibility of losses arising through causes that may be wholly beyond the control of the customer. A man may be doing a successful business, but in the event of his property being destroyed by fire, his failure to carry a sufficient amount of fire insurance might render it impossible for him to discharge his indebtedness in full. It is necessary that a merchant should be insured and for a sufficient amount. Where he overlooks his interests by failing to carry insurance, it is the credit man's duty to his house as well as to the customer to express a word of kindly advice upon this point.

In the sale of goods on credit there is a double risk assumed by the seller, the ordinary credit risk and also the risk from fire. The seller keeps his goods in a warehouse well-protected by insurance. There is no reason why he should be asked to take his goods out of a well-protected warehouse and put them into the store of a retailer or purchaser without the same protection given in the warehouse. The carrying of proper and adequate fire insurance protects both the merchant and the jobber or wholesaler and serves to maintain confidence and to strengthen credit. The customer's interest in fire prevention and fire insurance is frequently an index of his foresight and of his appreciation of his obligations to creditors.

This is not the place for a detailed discussion of fire insur-

ance, but no credit grantor or student of credit can fully understand the responsibilities involved unless he knows how important it is for a customer to keep well insured in good companies.

Liability Insurance.—The credit man, in order to protect his firm, must see that his customer is protected from any kind of sudden, substantial loss, inasmuch as such loss may result in failure in business and loss to the credit man's firm. A debtor may injure someone in an automobile accident and as a result of a suit for damages completely fail and be unable to pay his debts. An employee may abscond with large sums of money resulting in the financial embarrassment or failure of his house. An employee may be injured severely by a factory machine bringing about a suit that costs the employer heavily and places him in bankruptcy. Many other cases might be cited which would indicate the importance of the credit man's analyzing his risk, and, if there is possibility of loss through personal liability, demanding that the risk be insured to protect both the merchant and his creditors. The credit manager of today examines carefully all of his credit risks with reference to public liability as well as employer's liability, in order that the possible contingency of failure in this way may be avoided.

Life Insurance.—Capacity and character, two of the three C's of credit, both reside in personalities. Soundness of the credit basis requires that the business should be protected against a possible loss on the side of personality. Life is uncertain at best, and often the executives of organizations, who have been guiding geniuses for a period of years and have built the credit structure and secured credit recognition, die suddenly, leaving the organization to a very uncertain future. Successful credit men are learning to demand this form of protection whenever circumstances justify it, and thus not only

will they protect themselves, but they will also commit the debtor to a sound business policy.

The master minds and directing heads of big businesses are now usually found to be carrying insurance of this type. The one-man business, however, has quite frequently given little or no thought to this problem and here the credit man must be especially on the alert. The human equation looms large in the creditor's mind in the case of a one-man business. The skip of a few heart beats may mean the winding up of such a business or the turning over of it to an untried son or other relative. Also that intangible but vital asset—good-will—is always more easily impaired or wiped out in the one-man business. The man of small business is in desperate need of insurance protection.

S. S. Huebner phrased in an effective way the importance of life insurance when he said that "The most important new development in economic thought will be the recognition of the economic value of the human life. I confidently believe that the time is not far distant when, in wholesale fashion, we shall apply to the economic organizations, management, and conservations of life values the same scientific treatment that we now use in connection with property." [1] It should be emphasized that even in manufacturing and wholesale establishments the property values are not paramount, rather, it is the directing life values which are responsible for the earning capacity of these property values.

Credit Insurance.—Fire insurance protects physical assets while credit insurance covers assets which are represented by nothing more tangible than a set of figures on a ledger and the customer's reputation for honesty, judgment, competence and financial responsibility. The policy, sometimes called a "con-

[1] An address delivered before the National Association of Life Underwriters, July, 1924.

tract of guarantee on insolvent debtor accounts" or "a bond of indemnity," as well as a "credit insurance policy," is only issued to wholesale merchants and manufacturers, no provision being made for insuring retailers. It guarantees to the policyholder that the losses which he may sustain because of the insolvency of his customers shall not exceed those which are normally experienced in the regular course of business.

Early Development.—Credit insurance assumed no proportions of importance until 1900, and the amount of premiums paid never amounted to much over two million dollars per year, with the losses always considerably less than that. In its early stages the business was experimental, restricted insurance being written at low premium rates. In 1898, after the National Bankruptcy Act was passed, policies were broadened greatly so as to cover all forms of insolvency. From time to time they have been further liberalized. In 1916 "unlimited" policies were introduced, and one of the last steps is the addition of a collection service whereby accounts placed with the company are handled for collection as explained in detail later. The most outstanding recent development has been the adoption of a manual or mortality table for underwriting against losses. It is the culmination of a long succession of mathematical calculations based on experience which developed, step by step, the facts that yield the charges necessary to furnish the protection. The records of the companies covering a period of many years, reveal the private, precise, and full experience of thousands of wholesale merchants in every line of trade, including their sales to variously rated concerns and the losses thereon. From this information the Manual of Credit Insurance Rates was compiled. Prior to the perfection of the manual the underwriting was difficult and was largely a matter of judgment for the individual underwriter. Its adoption has rendered possible the training and development of

agents on a large scale, and there has been a gradual increase in the agency force.

Coverage.—This term refers to the amount of insurance to be written. The merchant may limit the amount of the policy desired. The company limits the maximum coverage on the account of any single customer of the insured. Coverage limitations have been developed on the basis of ratings of the various agencies, both general and special. All risks have been divided into two classes, "preferred" and "inferior." The first usually includes the two highest credit ratings for each capital rating, while the second includes the balance. The amount of coverage is definitely limited in dollars in the policy itself. Policies on "inferior" risks are written only on the basis of extra premiums.

Normal Loss.—A second fundamental factor in credit insurance refers to the practice of basing all policies on the customary, normal, or expected loss. No premium is exacted to cover the losses normally incident to the business insured. Instead, the policy-holder bears his normal loss and receives payment from the insurance company for the losses in excess of the normal.

Premium.—The premium is the charge made and is determined by coverage and normal loss and is figured first on the average of the various coverages on ratings, second on the sales volume, and third on the basis of any special hazards involved in the policy.

Points Covered by the Policy.—The policy is made up of the application, the insuring agreement, various conditions and stipulations, the premium, the coverage, and the definition of insolvency.

Policies are generally written for a period of one year, although some are written for a longer period. The policy is renewable annually, if conditions are satisfactory to the company. Each renewal policy may be so arranged as to provide not only for losses occurring during its term on sales of goods made thereunder, but also for losses occurring during such renewal arising from shipments made during the term of the preceding policy. The amount and condition of outstanding accounts at the date of the beginning of the renewal policy have a material bearing upon the terms to be named for the renewal pólicy.

Warranted declarations of the insured as to the condition of outstandings are made for the purpose of revealing information of a vitally important nature.

If an abnormal condition is indicated in respect to any outstanding accounts, a detailed list of debtors so involved is required by the insurance company before it acts upon the renewal policy.

Under the "limited policy" the aggregate amount of losses to be proved is limited to the face of the policy, which is limited to an amount commensurate with the premium charged. It may, however, be increased by any sum up to $200,000 by payment of an additional rate per $1,000 for the additions to the face amount. The limited policy thus has a face amount which represents the maximum liability of the company on the total of losses covered.

The unlimited policy has no face amount, and therefore no limit to the amount of insurance that may be so collected under the policy on the aggregate of the losses covered. As long as the individual losses come within the amounts specified in the table of ratings contained in the policy, they will be paid, regardless of their total amount. The unlimited policy is issued, however, only where the largest amount on any one individual debtor is limited to an amount not regarded as excessive for

this form of policy. For an unlimited policy an extra premium charge is made, over and above that for the limited policy.

The non-collection form is the same as the collection form, except for the omission therefrom of those clauses appertaining to collection of accounts, and a clause in the section defining as insolvency the past due accounts placed with the company for collection.

The collection policy is in two forms, one known as the "optional" collection policy and the other as the "compulsory" collection policy.

The optional collection policy permits the insured to elect whether he shall file an account due and payable, but not over 60 days past due, with the company for collection and have it admitted, for the purposes of the policy, as insolvent. Where a past due account is not filed for collection, but the debtor becomes insolvent during the policy period, the account must then be filed with the company for collection. This optional policy is at a fixed premium, and limits the liability of the company to past due accounts filed and accounts becoming insolvent during its term of one year. The renewal privilege applies to this optional form.

The compulsory collection policy provides that no loss shall be covered on any account unless placed with the company for collection before it is 75 days past due. If an account is more than 75 days past due it is not covered under the policy, whether or not the debtor becomes insolvent. This policy is framed particularly for those houses which are willing to pursue in their business the rule of prompt collecting.

This compulsory form protects against covered losses, whenever they occur, on all sales made during the policy period, and therefore needs no renewal privilege. The advance premium is the minimum, and if the sales during the year exceed the sales estimated at the time of the issuance of the policy, an additional premium on sales in excess of the policy minimum is

collected in the same proportion. This is necessary because covered losses occurring after the policy expires, on all sales made under it, are provable.

Under both forms of the collection policy the company proceeds to collect the amount of the account as soon as it is filed, and remits promptly to the policyholder the amount it collects, less, of course, the agreed collection charges. The uncollected part of the account is proved as a claim for loss under the policy and the policyholder is relieved of the burden of otherwise proving his claim.

The service is not rendered with a view to yielding a profit to the company, and does not do so. It is a service feature said to save policyholders numerous losses. In cases where the debtor is insolvent, the company prevents much waste where creditors themselves, either through ignorance of the law or by carelessness, do not preserve their rights.

Insolvency and Losses.—The determination of insolvency and the procedure followed in establishing and paying losses are important. In addition to covering a case where the account is filed with the company for collection, the term insolvency includes certain items covering actual insolvency, and impairment of assets. This would include a situation where the assets are held in any judicial proceeding to be insufficient to pay debts in full; where a petition in bankruptcy has been filed, where debtor offers compromise, makes assignment, or absconds; where any lien has been given on the property of debtor; where the debtor sells stock in trade; or where the debtor makes confession of a judgment.

Advantages.—It is argued in favor of credit insurance that it gives the business man greater control over his costs, inasmuch as he need only add the premium, or cost of his insurance protection to his normal or initial loss and other

fixed costs to ascertain the exact cost of production, thus enabling him to compute his anticipated profits with a greater degree of certainty and accuracy. Second, it is also pointed out that it tends to make the credit man more careful, and forces him to keep a closer watch on his accounts in order to make certain that he keeps well within the provisions of his policy. He must strictly observe the changes in the agency capital or credit rating of his customers, for the losses are adjusted on a basis of the latest information that was available at the time the goods were sold. Thus it is argued that instead of eliminating the credit man, credit insurance serves as a guide to the credit man, and induces the exercise of care and caution on his part in the extension of credit. A third argument advanced in its favor is that when the risk of excessive loss from bad debts is insured against, the house can take larger chances in extending credit and thus increase the volume of business.

Objections.—Credit insurance can be abused much more easily than well used. To a credit man who is even slightly inclined to shirk his responsibility or take too long a chance it will prove fatal and against the best interests of his house. The very fact that he is dividing responsibility and putting the possible loss on someone else will make him more lenient in granting credits. The specific facts in regard to a customer which a credit man must watch to keep within the requirement of his policy are not extremely significant. The credit man's house will not be likely to hold against him a loss from bad debts if it is covered by insurance, provided that he can show that he has increased sales by taking this chance. It is often questioned if credit insurance, as now conducted, has any value to the strong, able, watchful credit man, and whether it does not constitute a burden on him for the benefit of his weaker brother.

Credit insurance, as it is at present employed, protects the insured to a limited degree against unexpected credit losses. Whether or not business men should carry such insurance depends largely upon the answer to the following question: Can an equal degree of protection be obtained in any other manner and at a smaller expense? Carrying insurance of any kind is a considerable expense, and if this expense can be saved over a period of years it is poor business to carry it; if the loss more than offsets the cost, both in money and from the standpoint of sound credit practice, then such insurance should be carried.

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Part V.—Credit Problems in Special Fields

CHAPTER XXVI

SPECIAL FEATURES OF RETAIL CREDIT

Credit for the Ultimate Consumer.—The era of transition in retail service which has led from "cash and carry" to "May we charge it?" has not been bridged without a great deal of spirited controversy. It is doubtful if the proportion of credit transactions to cash transactions will ever be less than it is at the present time in spite of the fact that we read such articles in business magazines as "Love not your charge customer less, but love your cash customer more." In the retail credit chain we find the ultimate consumer functioning as the last link. He it is who uses for the direct satisfaction of his wants that product which has passed successively through productive processes. He it is who illustrates Aristotle's definition of economics when he said, "That science which deals with individual income and expense," for the credit customer is continually attempting to balance his monthly expense with his monthly income.

Retail credit transactions are based on the ultimate purchasing power of the customer. Their success lies, in the last analysis, in the careful granting of credit to the reliable ultimate consumer; in the tactful collection of these credits—that is, in the scientific credit man. The successful retail credit man is the product of this era of cash to credit transition and has been able, through his own growth and policies, to justify the granting of credit to the retail customer.

The majority of merchants today realize that the extension of careful, scientific credit to their customers tends towards stability and permanency in store sales; facilitates the handling of adjustments and complaints; furnishes the opportunity for a greater personal appeal in advertising; serves as a tangible, statistical means for gaging the trend of store buying; and increases good-will in so far as the credit customer continues to receive courteous treatment and to think of the store as "his" or "her" store.

For the ultimate consumer there exists the ability to fill the immediate need without the immediate payment; a personal relationship with the store resulting from becoming "known" as a customer, more courteous sales and adjustment service and a consequent more perfect understanding of store policies; the probability that, at a future date when peculiar credit is needed, he—or more especially she—may be able to receive this credit based primarily on her former record as a good character and credit risk.

The Granting of Retail Credit.—In the dominating importance of the personal interview as a source of credit information is probably found the most distinctive factor relevant to the problem of granting retail credit. "Interviewing the applicant" is the touchstone of retail credit granting. If this is well done, success is achieved. Interviewing the applicant is a matter of systematic investigation, of well-planned blanks, of provision for organization routine and courtesy in opening and handling a large number of accounts. It is a matter of personality analysis, demanding a type of business acumen which brooks no comparison with the analysis of financial statements, or a Dun or Bradstreet rating book, though these may sometimes be necessary. In the words of the leading department store credit men of the country, "two or three of these interviewers who have been with us for the past four or

five years can almost instantly decide whether or not an account is good or bad during that period of time that it takes for the average woman customer to pass from the railing to the interviewer's desk." Experience with thousands of individual cases gives the interviewer what is sometimes termed a "sixth sense," so that the questions on his blank are oftentimes a means by which an impression or decision has been checked, rather than the original basis upon which the decision is made.

The Application.—The foundation of all accounts is, of course, the application, and the more thoroughly the application is taken the better prepared will the credit manager be to determine the extent to which credit is to be granted. Interviewing applicants is an individual matter. No rules can be set by means of which the information is to be gathered from each applicant. General conversation may develop more information than direct questioning.

The routine of securing information and the methods of filing such information are determined primarily by department policy. There are, however, certain basic facts which every store must know before granting credit to the retail customer. It seems unimportant, but the efficiency of a credit department can be measured by the exactitude with which names, initials, and places of residence are recorded. Inasmuch as retail credit is personal credit the business address, the business telephone, the name of the firm where the applicant is employed, the length of his service in this and other positions and the length of time he has resided in this community are absolutely necessary. Of like importance is the place where the applicant carries his bank account, the address of this particular bank, taking care to ascertain whether it be a central or branch bank, the kind of account and the exact name in which the account is carried. The customer may desire to pay by check. Here a

banking signature, if different from the crediting signature, should be secured. Knowledge as to whether the applicant is a property owner and the type of his interest in that property also aids in measuring his ultimate paying ability.

The careful credit man should ascertain other facts; the establishments in which the applicant has formerly enjoyed the charging privilege, if any; the approximate age of the applicant; the name of a relative or friend now living in the city, or similar information concerning a former employer. Often such miscellaneous information as, "Sold home in Chicago just prior to leaving for Los Angeles. I am now receiving payments through the Continental Trust Company of that city," aids greatly in the final determinations of credit granting.

Checking the Application.—For purposes of internal administration it is important that the person opening the account have his name indicated on the original application card. If the account has been opened by the wife, it is important to get the name of the husband in order that he may receive a letter giving him knowledge of the fact that an account has been established. It often occurs that two or three members of the family may wish to use the same account and, when this has been authorized by the credit customer, their names should also be included on the blank.

In the granting of retail credit it is of prime importance that the customer understand that bills are rendered and due monthly; that, should any special or emergency credit be desired, this matter must be taken up in person with the credit manager.

With the aid of his peculiarly developed "sixth sense" the successful credit man is able to determine with a fair degree of accuracy whether this new applicant will be a desirable credit risk. However, retail credit can not be entirely a matter of character and identification and the credit man must determine

as far as possible the applicant's capacity to pay. For this information he checks first the employment, bank and personal records of the applicant either by letter or telephone. If the applicant has stated that she has a charge account in a local store or in another state, it is a comparatively simple matter to secure information concerning her credit standing through the retail central clearance offices.

Credit Limits.—The determination and enforcement of monthly credit limits which a customer may enjoy is a matter of store policy. These limits, however, should be determined at the time of the initial interview with the applicant, if possible, and should be dependent upon the economic status of the individual. In the case of the average salaried person it is a matter of common practice to place the limit as one-fourth of the monthly salary. If it is found that the customer has exceeded her credit limit, the matter is sent to the refer clerk who, having access to collection files and ledger information, refuses or extends the credit, the decision being dependent upon the former credit standing of the individual and the wisdom of her purchasing. At this time a personal interview with the customer is often desirable.

Customer Identification.—One of the problems of credit extension which must be solved is that of customer identification "on the floor." In order to protect the customer against fraudulent buying on her account, it is necessary that some means of identification of the customer when giving the charge be perfected. Several systems are in use at the present time, namely, presentation of charge coins or courtesy cards, floor manager identification, or customer signature—none of them fraud proof.

The principle underlying the issuance of charge coins and courtesy cards is fundamentally the same—that each credit

customer is given an account number. This number is assigned to her by means of the charge coin or courtesy card and authorization of her charge is made relatively simple by the presentation of one of these means of identification. The coin number and charge name must, of course, coincide when the charge is sent for authorization. Against these means of identification it is argued that coins and cards are readily lost or forgotten. In case of loss there is the danger of fraudulent buying on the account unless the coin loss is reported immediately. Customers often will shop elsewhere when their identification means has been forgotten rather than submit to the delay and possibly unpleasant questioning by the floor manager. In many stores this difficulty is overcome by asking the customer to place her signature on the charge check for identification and this check is then authorized by a comparison of this signature with that already secured for the visible files.

The system of identification by the floor manager presupposes the employment of capable, conscientious men, and their training, preferably by a credit official, in ways of tactfully securing identification in the personal interview with the customer. Identification having been secured to his satisfaction, the floor manager O. K.'s and initials the check and it is sent through the usual channels for authorization. From the standpoint of the customer, this is probably the most satisfactory means of identification. The delay in reaching the floor manager is usually slight and the small personal contact cheerful and friendly, offering an element of personal interest. The success of the system depends entirely upon the selection and training of these men.

Few stores at present require the signature of the customer on all charge purchases. It has been found, however, that the request for signature on charge-take purchases has proved a ready means for preventing fraudulent buying.

To the customer, credit authorization means little more than having to wait a short time for the delivery of her charge-take purchase, or, perhaps, a requested interview with the credit manager when her credit limit has been reached.

The Returned Goods Problem.—The granting of retail credit can not prove profitable to an establishment if its customers repeatedly charge more goods than they desire and issue a "wagon call" for their return. This "returned goods evil" has necessitated the organization of an adjustment department and its close cooperation with the credit manager. In the past goods have been charged, used, and their re-acceptance by the retail establishment demanded on the basis that these goods have not been paid for and therefore really belong to the store. Educating the public to the unfairness of returning such goods and the consequent financial loss to the establishment was greatly furthered by the conditions arising during the recent war, yet much remains to be done. At present most establishments have set a three to five day limit for the return of goods, have carefully defined the type of goods which may be returned and have reserved the privilege of refusing the return of goods soiled or damaged while in the customer's hands. Exchange and adjustment conditions are becoming better but are still open to great improvement.

Retail Credit Department Organization.—In the operation of retail credit, the credit manager has become an increasingly important factor in the success of the retail establishment.

Having received the application and made a temporary decision as to the line of credit to be granted, the remaining duties of the retail credit department are included in such items as, authorizing charge purchases from day to day, keeping up the

credit records, cooperating in the handling of complaints and adjustments, and developing a collection system which brings in the payments as regularly as possible from month to month. With numbers of personnel and limitations of duties dependent, of course, upon the size and scope of the credit department, credit organization, in general, includes (1) the credit men who interview the customers, take the credit application and establish a temporary limit; (2) the clerks who check the application for further inquiry, and follow up, record and file the information thus secured in the prescribed manner of their particular organization; (3) the clerks who compile and forward the necessary credit information to the auditing and billing departments; (4) the charge authorizers who O. K. credit who facilitate the handling of past due and difficult accounts charges within the determined limits; (5) the collection clerks which come to their notice through the charge authorizers or auditing departments.

Probably the most vital problems arising in the granting of retail credit are those of securing reliable credit information concerning the applicant, of promoting the rapid authorization of charge sales with a maximum of efficiency, and of collecting from the retail credit customer.

Clearing Retail Accounts.—The range of information to be secured from the customer at the initial interview has been stressed. It remains now for the credit department to check such information, determine as definitely as possible the standing of that customer as a credit risk, and to make a final decision as to the credit limits to be enjoyed by that customer. With the rapid increase in demand for retail credit and the advantages to the merchants resulting from such demand, there has arisen in most large civic centers a Retail Merchants Credit Association. This association, taking as standard for its operation a modification of the principles of Dun and Brad-

street, serves as a clearing house for information on retail credit customers.

When an application for credit is made in one store by a person who enjoys or has enjoyed the credit privilege in other stores, it is a comparatively simple matter to secure information concerning the credit standing of this customer through this Central Clearance Bureau. The Bureau requests the desired information—usually the date of opening the account, the highest credit, the amount now owing, for what months and the date of the last purchase—from those establishments which are recorded as having had credit dealings with the customer. This information is compiled and forwarded to the source of inquiry. Upon its findings credit may be granted or denied. These central clearance offices have proven invaluable, both to the buyer and the seller, for this information is available to all bureau members and the individual buyer is able to open an account at two or three stores with very little time and trouble in the transaction. For the seller it makes available complete information of the experience of other establishments with that particular applicant.

Cooperation between banks and retail credit men has become increasingly beneficial. The relationship between the bank and its depositors is, of necessity, confidential, but with the increasing proof to the banks that credit managers use the information given them wisely, it is now possible to secure such information as the bank is able to offer concerning the applicant's financial standing.

Should the account be the first established, it is important to secure the employer's estimate of the character of the applicant and his capacity to pay. Personal references serve as a means for identification of the new customer and may prove to be the source of valuable information concerning those customers who prove to be real collection problems.

Authorizing Charge Purchases.—The question of authorizing charge purchases involves so many different accounts each day that mechanical assistance by means of which action can be taken quickly in the matter of credit sales is absolutely necessary. The authorization of the sales checks is a vital item of service in all retail organizations. It is the basis of all charge records; the original is the posting and billing medium; the duplicate is the customer's memorandum; and the voucher, after being O. K.'d and acting as an authority for wrapping, is used for auditing purposes.

In the small store the authorization of charges is scarcely a problem. When the sales check is completed, the clerk either takes it to the credit office or sends it by messenger. It is presented to the credit manager or bookkeeper and returned "checked." In a city where thousands of active accounts must be authorized daily, it is absolutely essential to have speed together with safety and accuracy.

Before authorization is given, identification of the customer must be made. Identification being satisfactory, authorization may then be secured by folding the sales check, charge name and address outside and inserting it in the colored carrier used for the charge-take purchase. These checks are then either handled by a charge authorizer in the tube room or relayed to the credit department where the O. K. stamp is placed upon the check and it is returned by tube to the wrapper's desk. To secure authorization by electric telephone the salesperson or wrapper inserts the check in a small register, secures connection with the authorizing room by pressing a button which flashes a light at the authorizing keyboard. A slight ring signals the salesperson that the authorizer is ready to receive her charge. The name, address and identity of the person buying (if she is authorized to buy on the account but the account is not in her name), and the amount of the sale

are transmitted to the authorizer who consults her visible files and O. K.'s the credit by pressing a button which releases an electric device that perforates the inserted sales check.

The relative merits of the tube or electric telephone methods of authorization depend primarily upon the size and organization of the retail establishment. It is argued that mistakes in authorization resulting from incorrect taking of names, initials, or addresses on the part of the salesperson are minimized by the tube system of authorization because that system requires the handling of the check by a second person and the direct comparison of those details with the visible files. If the request for authorization by telephone is made by the wrapper rather than the salesperson, however, there is here a second person handling the transaction and serving as a check upon the accuracy of the salesperson. With the increasing size of an organization, the tube system is in danger of becoming unwieldly, especially when the tube is used for other than charge transactions. It then becomes necessary to devise a system of special carriers and to duplicate or transfer the authorization files to the tube room to avoid the loss of time in relaying these charges to the credit department. On the average, authorization by tube is accomplished at the rate of one every sixty seconds. Authorization by telephone, eliminating the folding, sending, unfolding and re-sending of the check, is accomplished on an average of one every thirty seconds—a decided factor in the busy retail establishment.

In smaller establishments it is feasible to have the central authorizing room located in the credit department, thus making possible a more accurate check on credit risks. In large establishments there may be a central authorizing room with duplicate files in the delivery room and authorizing room. In the latter case the delivery room authorizes by stamp all charge-sends, the authorizing room taking care of charge-take transac-

tions. All questionable credits are, of course, referred to the credit department.

Behind successful charge authorization must lie the cooperation of the ledger and billing clerks who report each day to the credit department accounts over the limit, partial payments on accounts and accounts past due. It is then the responsibility of the credit department to see that such information as is of value to the authorizer be placed on the visible credit files now in current use.

The authorization of those charges which would place the value of monthly purchases beyond the established credit limit usually falls to the refer authorizer, who advises the credit manager of the situation if he feels unable to pass judgment. In deciding what action to take on these charges it is well to consider the former paying habits of the customer, how long she has been a patron and what kind of merchandise is being purchased. Irregular or heavy purchasing may prove a danger signal. A personal interview with the customer at this time may prove a very satisfactory means of handling the doubtful situation.

The Retail Credit Man as a Sales Builder.—The successful credit man efficiently supervises the handling of those sales which cover approximately 50% of the retail trade but he does more than that. Working accurately on the assumption that the advantages of the ability to "charge it" are appreciated by the customer and prove business builders for his organization, the alert credit man actively solicits new accounts. From various sources he secures the names of new arrivals in the city, estimates their probable value as credit risks and issues an invitation to open an account with his organization. Telephone and business directories and "Blue Books" have proved valuable as means for securing new names, advertising, and

soliciting accounts. The efficiency of a credit man should not be judged solely by the low ratio of his credit losses but he should also be considered in connection with the amount of business that he brings in.

Collecting from the Retail Buyer.—Wholesale collection involves dealing with men who are in business and who, to a certain extent, understand the problems of business, the importance of financing a business and the essentials of a sound collection policy. The retailer, on the other hand, is selling to thousands of individual people engaged in different occupations. Some of them never come into contact with questions of credit or business financing save as they are called upon to pay for the goods which they have consumed and which have been furnished them from month to month by the retailer. The collection policy must necessarily, then, be one which can be made to apply to a large number of individuals. The retail credit man is dealing in personal credit. He sells consumption goods, goods which, in many cases, have disappeared by the time payment is due, leaving only the vague memory of satisfaction enjoyed. All these points tend to make the way of the retail collector difficult and he must make his appeal fit the particular situation in accordance with the problems involved.

The mediums through which wholesale or retail collections are made are essentially the same: the statement, a system of letter follow-up, the use of telephones and telegrams, personal collectors or collection agencies and legal procedure. In retail collection there are probably as many collection systems as there are retail establishments but behind these systems there lies essentially the same objective—to secure the payment and retain the good-will of the customer.

The monthly statement serves as a reminder to the customer that payment for her purchase, under the conditions

explained when credit was granted, is now due. The store policy defines the time limits beyond which an account is considered overdue, some considering an account to be overdue at the expiration of the thirty days, others extending the time and some few even allowing a customer to take six months credit and still retain good credit standing.

The Overdue Account.—The overdue account having been turned over to the collection manager, he proceeds to collect. An average of from four to six letters are sent to the delinquent customer, their content depending upon the policy and ingenuity of the collection manager. Form letters are coming into disrepute because of their evident mechanical make-up and failure to fit the individual case in hand. Form paragraphs are, however, most valuable, and when properly filed and keyed afford a great aid for stenographic composition of collection letters. Stickers and stamped announcements that the account is past due on the monthly statements often prove a means for collection and avoid the item of letter follow-up.

The use of the telephone and telegram are of undisputed value. The telephone serves as a time saving method for informing the customer verbally that his account is long past due and a remittance is desired, also a verbal statement is often much more forceful than an increasing influx of written ones. The telegram is a most forceful reminder, impressing the debtor with a need for haste, but this telegram should be well timed and carefully worded that it may not prove a legal weapon in the hands of the debtor.

When other methods fail, the retail establishment has recourse to its personal collector or "outside man" who calls on the delinquent and requests payment; or a forceful letter may be written on the letter-head of a purported collection agency; or the account may be turned over to an attorney for collection

and legal steps taken. All of these methods have their relative advantages and disadvantages and should be adapted to fit the case in hand. In localities which are so fortunate as to have the Retail Credit Men's Association serving also as a last resort collection agency, it is often possible to secure payment through a letter from the agency explaining to the delinquent the seriousness of impairing her credit standing with that organization.

Points in Good Collection Management.—The successful collection manager knows each day the accounts that should come to his attention on that date. Such information necessitates a perfect follow-up filing system. The most accepted system for this purpose is the "Diary dating system," in which the folders, of size to contain correspondence without creasing it, are numbered consecutively from 1 to 31 and represent the current and one or two succeeding months. By this means all information concerning a delinquent account may be filed at the date at which a reply to correspondence may be expected and a perfect check thus kept upon its collection standing. When forceful or legal methods must be taken to secure the payment of an account, separate records and files should be kept of these accounts, the names should be removed from the active charging lists and further action taken on these charges when the account has been cleared. At this time these accounts may either again be placed on the active files or further credit refused.

The collection manager must never lose sight of the fact that he is not only an important medium through which the store is able to liquidate its debts and increase its turnover, but a salesman of store good-will. His policy must be that of educating the customer toward paying her debts promptly, of assuring her of the favor she is granting the store in accept-

ing credit, of creating in her the desire to continue her pleasant relations with that particular establishment.

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CHAPTER XXVII

INSTALLMENT SALES AND COLLECTIONS

Extending the Time for Payment.—During the past decade, selling on the installment plan has seen phenomenal growth. For many years before business men realized the full possibilities of this method of sale, though it was more or less common to sell real estate, furniture, and pianos on the installment plan, to think of selling other articles in a similar manner was out of the question. Thus the growth of installment sales dates practically from the beginning of the twentieth century, its possibilities foreseen by the growth of the automobile industry and the incorporation of companies to finance the purchase of cars on the installment plan. Articles of every description for modern consumption are now being sold on this basis. The government itself used this plan in floating the Liberty Loans, with the result that a market hitherto non-existent was created for the sale of billions of dollars worth of bonds.

Ethical Considerations.—Ethical considerations weigh heavily when viewing the ease with which installment credit may now be received. With a nickel assuming such proportion as to serve as initial payment on a phonograph, the question arises whether it be ethically sound to urge such liberal credit—a credit that may prove the indirect means of mortgaging the average individual's entire income through monthly payments due for desired possessions. Whatever the considerations involved, it is true that installment sales and credits are coming to occupy a large part in sales transactions and offer a large profit to the successfully operating installment

house. The question as to whether or not such selling is desirable depends upon the answer to the question, "Is the buyer more productive through the use of these goods than without the use of these goods?"

Plans of Payment.—The credit aspect of installment selling differs only from ordinary credit transactions in that payments on the particular articles are arranged in consecutive order in such a way that in a period of time individual commodities are completely paid for while the buyer has the use of these commodities during that period. It is, of course, a lengthening of the credit term with an attempt to withhold good title in a more or less durable object until the terms have been complied with. The merchant who sells on the installment plan has the advantage over the merchant operating on the retail charge account basis, in that he usually receives a cash down payment and withholds complete title to the possession of the goods by the purchaser until such time as payments have been satisfactorily completed. His credit risk is, however, necessarily greater, his major activities resting in the credit and collection departments.

With the growth of those establishments which sell merchandise on installment credit primarily, it has become necessary for the retail establishments to encourage sales within their stores on the installment basis. Such sales furnish a large field for advertising and sales promotion, vastly enlarge the field of credit operation, and, it has been asserted, encourage the sale of approximately fifty per cent more merchandise. Through the offering of contract sales, people with little money are enabled to purchase now and pay later, thus encouraging thrift that payments on an enjoyed article may be completed and its final possession secured. The retail establishment, however, operates on a smaller margin of profit. The down payment is therefore apt to be greater and will be dependent upon

the resale value of the article. For example, furniture and rugs usually require one-fourth to one-third down payment; musical instruments, one-tenth; draperies, one-half. The greater the equity a purchaser has in an article, the more careful he will be in his use of it and the more anxious he will be to pay his obligations. Payments are usually distributed so that the account will be cleared in not more than a year.

Operating as it does with a larger margin of profit, the installment house is able to take greater risks, selling its goods with an initial payment often as low as 8 per cent. Subsequent payments are usually heavier, however, with the indebtedness distributed in such a manner as to secure its clearance in not more than five months.

The installment business offers increased opportunity to the buyer as well as to the seller. As his benefit, the buyer receives the use, enjoyment and future possession of articles which he might otherwise be unable to purchase. The seller is afforded an opportunity for increased business and increased profits if he is careful in his selection of credit risks, in his decisions on values and terms of sales, in his collection policies and in his determination of the point at which repossession of the articles sold is desirable and justified.

Financial Problems of Installment Selling.—The business house which expects to sell on the installment plan must face squarely certain problems in order to insure success. The first problem is, of course, the increased demand for capital. The need for working capital comes from the cost of the goods, the selling cost which must, necessarily, be added to the cost of the goods which are to be sold, and the administrative costs which must also be included. If there is any variation in the plan of selling by which the time is extended from the date of selling to the date of collection, there is a resultant increased demand for working capital. Any expansion of sales

is apt to work disastrously to the firm unless there is sufficient capital to meet this demand. Let us take the hypothetical case of a product which sells at a retail price of $100.[1]

> Coming back now to the financial problem of carrying on an installment business, let us take the hypothetical case of a product which sells at a retail price of $100. We will say that the cost to the manufacturer or retailer is $60, the selling expense is $20, and the overhead *charges,* including collection expense and loss, are $10, leaving net profits of $10. We will assume that the firm which sells this product disposes of 50 of the articles during the first month of operations; 100 the second month; 150 the third month; 200 the fourth month; and thereafter regularly sells 200 each month. We will assume, further, that installment payments are made at the rate of $10 per month. In order to simplify the problem, we will make the arbitrary assumption that the whole $90 outgo, including collection expense and loss, is incurred at the time each sale is made. Under these assumed conditions, how much working capital will be required to "swing" the stated volume of business? During the first month outgo would be 50 times $90, or $4,500, and the cash receipts would be 50 times $10, or $500, leaving a cash deficiency of $4,000. During the second month the outgo would be 100 times $90, or $9,000, while the receipts would be $500 covering sales made during the first month, plus $1,000, for sales during the second month, making a total of $1,500; leaving a cash deficiency of $7,500.

		Outgo	Receipts	Cash Deficiency for Month	Accumulating Deficiency
First	month	$4,500	$500	$4,000	$4,000
Second	"	9,000	1,500	7,500	11,500
Third	"	13,500	3,000	10,500	22,000
Fourth	"	18,000	5,000	13,000	35,000
Fifth	"	18,000	7,000	11,000	46,000
Sixth	"	18,000	9,000	9,000	55,000
Seventh	"	18,000	11,000	7,000	62,000
Eighth	"	18,000	13,000	5,000	67,000
Ninth	"	18,000	15,000	3,000	70,000
Tenth	"	18,000	17,000	1,000	71,000
Eleventh	"	18,000	19,500	500	70,500
Twelfth	"	18,000	19,500	1,500	59,000

[1] Lough, W. H., *Business Finance*, p. 402

It is clear from the above table that, in case the installment seller intends to carry the whole burden of financing on his own shoulders, he must be prepared with a working capital amounting at a maximum to $71,000. Unless his business afterwards increases more rapidly than his cash receipts, he will be able later to draw large profits in cash which are the accumulating result of sales that he has made during the preceding months.

Loss of Capital Through Bad Accounts.—A second problem arises in the loss through bad accounts. This is particularly true in connection with the sale of consumption goods such as pianos, phonographs, vacuum cleaners and books. There is a thrill and interest in the newly purchased object which makes payment easy within the first ten or thirty days, but after the newness has worn off and the article has become slightly shabby or worn, the buyer has a thousand excuses as to why he should not be particularly interested in meeting his payments regularly. This natural inertia is one of the serious difficulties in connection with installment selling. As business grows and the number of these accounts becomes greater there is a constantly increasing cost of goods sold which has to be compensated for by additional working capital and additional collection costs.

Remedial measures in installment financing have been well outlined as follows:

> When the dealer has arrived at a point where the amount owing him in installment accounts has reached the previously determined limit of prudent capital investment; or, in the absence of such previously determined amount, realizes that he is becoming hampered and restricted for want of cash, it is surely time for him to apply the brakes. This can be done in two ways: first, by refusing new business in excess of the amount currently realized from collections; and second, by arranging for new capital, or by pledge of lease contracts as collateral. It is important and fundamental that such loans shall be self-liquidating, and shall have no other fixed due date. Carefully selected contracts, with an initial

payment of at least twenty-five per cent of the purchase price, make it a sound and profitable investment. The dealer must, however, take care to see that the charge for the service is not excessive, or so burdensome as to rob him of all profit. This new capital is variously obtained from the dealer's own bank, financing companies, or friends.[2]

Management of Installment Sales.—Unique problems present themselves in the granting of installment credit. The house granting such credit is, of course, protected by the sales contract and enabled to secure repossession of its goods in case of default of payment, but these are "last resort" methods. The primary aim of credit granting is the arrangement of such terms that the buyer may be able to meet his payments when due and secure final possession of the desired article in his own right.

Of prime importance, therefore, in the determination of installment credit is the moral risk involved, hence the emphasis that is placed by all credit men on an accurate determination of the character of the applicant. Estimation of his honesty and integrity may be verified by securing statements of his past record from such sources as he may suggest or the position of the house make available. In the moral risk involved, there must also be considered the customer's willingness to pay, the determining factors of which may be: his place of residence—whether commensurate with income as represented and accompanied by a fair degree of permanency of residence; his environment; his social connection; his marital status; his occupation; and his intelligence. The ability to pay may be estimated from the financial record secured from the applicant, taken with due reference to his probable willingness to discharge his indebtedness. The ability to pay deter-

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[2] B. W. Griffin, *Installment Sales and Collections*, p. 13.

mines the limit of credit to be granted, serving as an aid in singling out persons who are inclined to be too extravagant and hasty in their purchasing.

It is often impossible to secure from those asking credit in the installment house a definite statement of their financial position and obligations. It is essential, therefore, that the credit man secure in his interview the amount of weekly, monthly and yearly income (indicating steadiness of employment) and a statement of any legal trouble the applicant may have had. These facts secured, the credit manager is enabled to make a fair estimate of the moral and financial risk involved, to extend his credit and state his terms.

Installment Sales Procedure.—The retail establishment which is not primarily an installment house completes the conditional sales transaction in various ways. Those sales which are made on a basis of monthly credit settlement—the charge account—are completed on the basis that goods are delivered; it is assumed that the title has passed to the purchaser, and the seller has for his protection an open account of the transaction which he may or may not collect. A second method, sometimes used when purchases are unusually heavy, is that of having the buyer sign a series of notes due on certain dates, each one of which is an obligation in itself and which must be paid. The third method is one in large use in installment houses and assuming greater importance in other retail establishments—the sale of goods under the conditional sales contract in which title does not pass to the purchaser until the completion of the installment payments for the purchase. To aid in understanding the additional protection which such a sales contract affords the seller and its consequent advantages in sales transactions, a typical form of conditional sales contract is reproduced:

Conditional Sales Contract

Los Angeles, Calif..............192..

The A. B. C. Company, hereinafter sometimes called the Seller, promises to deliver to.........................., hereinafter sometimes called the Buyer, and upon the payment of the whole purchase price hereinafter recited, will convey good title to the following described article or articles to the Buyer, to wit:

The said Buyer promises to accept said article or articles and to pay the whole purchase price therefor in the manner and at the times hereinafter provided.

Delivery: Article or articles to be delivered f.o.b.................. on the...........day of.............., 19....

Purchase Price: The purchase price of said article or articles is .... ($...........) Dollars, payable & .... ($...........) Dollars cash upon the execution of this instrument, and ....

Interest: Deferred payments on the purchase price shall draw interest at the rate of......per cent. per annum from the.................day of ...., 19...., and may at the request of Seller be evidenced by notes.

Title: The title and ownership of said article or articles shall remain in The A. B. C. Company until the whole purchase price is paid. Upon Failure to pay any installment of the purchase price, or upon default herein, or breach hereof, on the part of the Buyer, the said The A. B. C. Company, shall have the right of recaption and may, without let or hindrance, seize and retake the article or articles into its own possession wherever they may be found. In which event all moneys theretofore paid by the Buyer on account of the purchase price shall be deemed and considered as payment to the Seller for the use, enjoyment and possession of said article or articles from the time of delivery until the exercise of the right of recaption. Further, in such event, the Buyer waives any and all claims to damages that may arise or accrue to him from such seizure and from this transaction as a whole, and agrees not to lay claim to any damages against the Seller on any account, or for any reason whatsoever.

Upon payment of the full purchase price, a proper bill of sale will be executed and delivered, transferring title from The A. B. C. Company to the then purchaser.

If the Buyer should give a note or notes for the balance of the purchase price, it is distinctly understood that said note or notes are not accepted as payment, so as to pass title. Under no circumstances shall title to said article or articles pass from the Seller until the whole purchase price is fully paid in money. In case notes are given and accepted they are to be deemed a part of this contract. Should any installment of the purchase

price or of the interest thereon (whether represented by note or otherwise) not be paid when due, then the whole of said purchase price and interest remaining unpaid shall become immediately due and payable at Seller's option. In case of any action to recover any sum hereunder (or any note or part thereof), Buyer promises to pay reasonable attorney's fees. Buyer's rights hereunder shall not be assigned without written consent of the Seller. Said article or articles shall not be leased, nor shall Buyer part with possession and control thereof. Buyer hereby assumes all liabilities by reason of any accident or injury to persons or property arising out of the existence, use or possession of said article or articles, and agrees to save Seller harmless from any such liability, including cost of legal defense. Any payments made by Buyer shall first be applied to the liquidation of any repair bills or other indebtedness due Seller outside of or independent of this contract; thereafter any payments shall be applied hereto.

Safe Keeping, Etc.: The proposed purchaser shall be responsible for the safe keeping of said article or articles; the Buyer will insure the same for value, loss, if any, payable to Seller, or if not insured by Buyer, the Seller may insure same and the Buyer agrees to pay said insurance premium on demand; Buyer agrees to pay freight and all setting up expenses; Seller will not be held responsible for any reasonable delay in manufacture or any other delay in fulfillment of this order due to strikes or any other causes beyond its control, or for any damage to article or articles delivered and receipted for by the transportation company in good order. In case The A. B. C. Company is to take second-hand article or articles in exchange, the undersigned warrants them free from all liens.

Buyer shall safely keep said article or articles in proper repair and at all times in charge of competent persons. The A. B. C. Company reserves the right to inspect said article or articles during business hours. Seller may retake said article or articles at any time if, in its judgment, the same are being misused, or not kept in good order, and in such event Buyer shall pay on demand, and independent of the other provisions thereof, costs of any repairing of said article or articles, and this even though there has been a recaption. Proposed purchaser shall not remove said article or articles from the County of..................without the written consent of The A. B. C. Company. If said article or articles are attached or levied upon by any alleged creditor of the Buyer or if a petition in bankruptcy is filed by or against the Buyer, then Seller may immediately retake possession of the said article or articles and all moneys theretofore paid shall be considered as compensation for their prior use and possession. Any expense incurred by Seller in the process of recaption shall be paid by Buyer on demand, including necessary repairs and expenses of transporting article or articles back to Seller's place of business. In case the Seller commences any action to replevin said article or articles, the Buyer prom-

ises to pay reasonable attorney's fees in said action to be fixed by the Court.

IN WITNESS WHEREOF, the parties hereto have executed this conditional sale contract the day and year first above written.

THE A. B. C. COMPANY
Per............................
....
....

In nationally operating installment houses it is the custom to secure, record, and file a chattel mortgage on the purchase. This method is probably found most expedient for nationally operating business because of the greater uniformity offered under chattel mortgage procedure and protection.

Collecting from the Installment Buyer.—The collection manager of an installment house must be a most convincing salesman. To be sure, he holds in his possession a lien upon the property for which he is trying to secure payment but he has no desire for its repossession. It is his duty to resell that particular commodity to the customer who has already enjoyed its possession, to awaken interest and pride in possession in such a manner that future payments may come regularly and promptly.

The general procedure in installment collections is essentially that of other collections with varying emphasis upon individual problems. The installment collector must not only continually resell his goods; he must watch installment payments on account, must be alert to recognize any change in the credit standing of the debtor or any attempt on his part to defraud, must be able to understand and deal wisely with requests for time extension on payments or complaints of dissatisfaction of the goods.

The routine of collection procedure varies little from that of other collection departments—the three or four letters of varying degrees of encouragement, interest or severity, warning the customer that his payment is past due; the handling

of special adjustment cases and extension requests; the legal pursuit of the difficult debtor; and the last resort of securing repossession of the purchase. It can be readily understood that there is a great need for tactful, sincere letters of proved salesmanship qualities to urge the customer to pay and yet increase the desire for possession. Of varying degrees of usefulness, dependent upon the case at hand, are the telephone, telegram, registered letters, letters from the house collection agency, from the house attorney, drafts, and when all else fails, threats of and recourse to repossession.

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CHAPTER XXVIII

DISTINCTIVE FUNDAMENTALS OF BANK CREDIT

The Bank and the Credit Relation.—The average commercial bank comes in contact with credit transactions through its two functions of (1) discount, or furnishing funds to its customers through loans, and (2) deposit, or the securing of funds to supplement its own capital for the use of its customers.

Credit is the principal thing which the bank has for sale. The customer buys credit, or purchasing power in the present, and promises to pay at a definite time in the future the bank's price. The bank's relation to credit is a most vital one.

The Bank Credit Manager.—It follows that the functions and problems of the man in charge of the bank's credit operations are very important.

The bank is a public institution and is responsible first of all to its depositors. It must be able to make payments at any time in accordance with their needs. It must arrange its own obligations in such a way that sufficient funds will at all times be available to make payments and supply its depositors with funds. On the other hand, the more money which the bank has, the greater its income or profit, so accordingly, while a bank desires to invest all its funds, it must keep some on hand to meet in legal tender on demand all claims of depositors. This is the "reserve." It insures the immediate payment of obligations. The amount of the reserve is a percentage of the amount of deposits, and is sometimes prescribed by law, although oftener prescribed by experience. A bank which

enjoys the confidence of the community may keep a smaller reserve than one which the community regards as weak.

By state and federal regulation, the various banking institutions are required to keep their funds in a certain degree of liquidity, i.e., they must invest in quick assets—stocks, bonds and commercial paper which may readily be converted into cash. In time of need, the bank may call in loans, and so automatically increase reserve; or it may sell its business paper.

The bank credit man thus finds that in order to fulfill his responsibility to depositors in such a way that his organization may grow and develop in the community, he faces the problems of regulating loans so that a sufficient liquid reserve is available to depositors. In so far as responsibility for loans is given him, he becomes one of the credit "governors" of the community.

When a customer of a bank applies for a loan, the credit man must conduct an investigation of his standing just as the credit manager of a commercial firm must when the same customer asks for credit from his firm. Moreover, the bank's per cent of profit is so small that it is necessary to take even greater precaution concerning repayment than the business man must do.

The credit investigation sources used are much the same as those employed in the case of commercial credit as, for instance, personal interviews, hand books, mercantile agencies, such as Dun and Bradstreet, statements of assets and liabilities, etc. The bank credit department has some advantages, however, over the commercial credit department in that the bank can easily get a great deal of information from other banks which is likely to be more accurate than if it were being given to a commercial house. This holds true, of course, because credit information is exchanged between banks. From checks and drafts passing through the bank, and from its close touch with mercantile houses, the bank can obtain information

sometimes unobtainable by any other firm, particularly where competition is keen. The bank credit manager also has another source of information which is very important if he can develop it properly. Officers of the bank come in close contact with borrowing customers and if they can be induced to put the results of their conversations in written form and forward them to the credit department, the files kept there can be made much more valuable.

Organization of the Bank Credit Department.—As banks have grown in size and the territory and industries interrelated with these banks have enlarged, it has become necessary to concentrate in a single department the activities connected with loans. The aim of good bank credit department organization is to have available for the loaning officers accurate information carefully analyzed. In some cases the credit manager is also asked to make recommendations on loans and lines of credit. After the information has been secured through the various sources indicated it must be classified so as to be usable with the least possible expenditure of time and effort. The plan of classification will vary with different circumstances. The following plan is typical:

Classification of Information.—On the left-hand side are found the agency reports, financial statements and comparative analyses. On the right-hand side, the history sheet appears first, followed by special reports, answers to inquiries on the subject, checkings, clippings and miscellaneous data. When there is a sufficient volume of information, the different groups are indexed. Upon opening the folder, the comparative analysis and history sheets appear first; this is desirable because these sheets properly made up constitute a brief survey of the account. The purpose of the history sheet is to show an account in its relations with the bank and to summarize its

position as a credit risk. This sheet should contain the following information:

1. Nature of business and how long established.
2. Management.
3. Date account opened.
4. Line of credit.
5. Way in which subject borrows.
   a. Secured.
   b. Unsecured.
6. Borrows.
   a. High
   b. Low
7. Average Balance.
   a. Month.
   b. Year.
8. Comments on analysis of statement.
9. General prospects of the concern.
10. Checkings.

The basic data for the history sheet is obtained from the liability ledgers, individual ledgers, general correspondence files, personal investigation, the officers acquainted with the account, and the information already gathered in the folder. It contains the credit manager's opinion as to the desirability of the account, which is based not only on the individual concern but on a general study of the industry involved. The history sheet is kept up to date by incorporating new information as soon as it is received, and over a period of years these collected sheets become invaluable.

One or more of the following files will be found desirable:

1. Current Borrowers.
   This includes the folders discussed above.
2. Banks.
3. Inactive.
4. Statement tickler.

Card showing date of last statement filed according to month in which new statement is to be requested.

5. Average balance card.
   Showing average balance and average liability by months.
6. Cross index.
   Indicates individuals connected with borrowing firms.

It will be found convenient to have a loose leaf folder in which are listed all borrowing concerns, classified according to industry. This will be of great service in picturing the distribution of loans, showing the amount centered in any one type of enterprise at any given time, and in case of unfavorable change in economic conditions, showing what borrowers are likely to be affected.

The Fourth "C" of Credit—Collateral.—Banks are quite accustomed to making loans on the basis of collateral. In this way it may be said that for one of the three "C's" of credit, that is, Capital, they substitute Collateral. Thus we find that the bank now depends upon specific assets pledged in the payment of particular debts in addition to the net worth of the concern which is borrowing. The idea back of a collateral loan is, of course, to place a bank in such a position that it can sell the property which has been pledged in case of necessity and liquidate the loan. Collateral should not be considered a substitute for character and capacity, though many loans are probably made on the basis of collateral alone.

Business concerns borrow money on the basis of securities which they own, on the basis of merchandise, and sometimes on the basis of real estate. Under certain conditions, any or all of these may be accepted as collateral by banks. In the case of securities, the amount which may be borrowed depends partly upon the quality of the security, but more especially upon its marketability. While a bank must be convinced of the

safety of a security put up as collateral for a loan, it is even more interested in whether that security can, in a few hours' time, be sold in the open market. If the borrower fails to pay the loan when due, the bank has the right to sell the security—and so the bank insists on security which is readily salable.

Collateral loans made on the basis of merchandise are on such commodities as cotton, wheat, leather, etc. Margins required vary with the buyer and with the community in question, running both above and below 25% of the value of the commodity. The particular documents used are bills of lading, drafts, and warehouse receipts. In certain lines of business special documents are developed to fulfill the need, such as the cotton mill sale note, or the mill acceptance, as it is sometimes called.

Real estate is sometimes used as a form of capital in the negotiation of a bank loan. Banks are limited in connection with this particular type of loan because it is not a liquid asset. However, a certain percentage of the capital of a bank may, without serious embarrassment, be invested in a loan protected in this way, depending upon the nature of the banking business and the legislation affecting it.

Discounting Commercial Paper.—The bank's function of discount is that which gives the borrower the right to receive at once the amount promised in a note minus the interest for the time the note will run.

Suppose a manufacturer, Mr. B., engaged in a productive undertaking, needs $10,000 to distribute and market his commodity. He has a promissory note (or some other form of credit instrument) for $10,000 from Mr. A., to be paid in two months. This he takes to the bank and asks for a loan on the security from Mr. A. All questions concerning the financing of a credit risk will naturally arise in this transaction, and the

sources of information and methods of analysis already suggested will be used.

If conditions are satisfactory, the bank discounts the note—subtracts from the amount of the note the interest and gives the customer the proceeds. At 6% interest, the merchant will be given $9,900, but when the note is due, he will pay the bank the full $10,000. Discount, then, means the deduction of interest in advance.

He may receive the loan in cash or bank notes, but usually the amount is placed to his credit in the bank. It is often said that banks lend the money which customers have deposited. This, of course, is true, but by far the greater deposits come as a result of loans, that is, loans make deposits.

The manufacturer draws on the account as he needs the money, and thereby is enabled to give credit to the merchant who buys from him. The merchant, in turn, gives credit to the consumer. Then the consumer pays the merchant, the merchant pays the manufacturer, and the manufacturer deposits this to his account. The note from Mr. A. falls due, is paid, and Mr. B. transfers to the bank from his account the $10,000 which he owes.

The whole credit transaction is possible because the bank lends now to Mr. B. on the basis of what Mr. B. will have in the future. Mr. B.'s wealth, unavailable now, becomes available for immediate use through the bank's function of discount.

The Federal Reserve Banks and the Function of Rediscounting.—Before the Federal Reserve Act was passed and the Federal Reserve Banks established, there was no strong centralized agency to which banks could turn in time of need; there was no certain market for the rediscount of credit paper normally held by commercial banks.

Under the Federal Reserve System, a bank which quickly

needs to increase its reserve may take its discounted commercial paper as well as other securities to the Federal Reserve Bank in its district and have it rediscounted if eligible and desirable, thus increasing its ready cash, in case of a "run," or in case of some other emergency. Referring to the example of Mr. B., if the bank which discounted the note presented by Mr. B. needs cash quickly, it may have the note rediscounted by the Reserve bank. When Mr. B. pays off his loan, his bank can then settle with the Federal Reserve Agent. The function of rediscounting has done much to increase confidence throughout the business community, and to facilitate the negotiation of loans for productive purposes.

Eligibility of Commercial Paper for Rediscount.—The large part of the banking resources of the nation which it was expected would find their way into the Federal Reserve Banks, made it imperative that there be rules as to the maturity of the paper rediscounted, and as to its origin.

It is essential that Federal Reserve Banks invest in short-time, liquid securities, so that at all times funds will be available to perform those functions for which the banks were created and the law passed and which are so necessary to our continued financial stability and strength.

The Federal Reserve Act defines in rather broad terms the kind of paper which is eligible for rediscount and the more exacting qualifications are promulgated by the Federal Reserve Board. The regulations of this Board have been revised from time to time and constitute the test of eligibility. The general provisions which affect eligibility pertain to either the maturity of the paper or its origin and the use of the proceeds.

The maturity, at the time of rediscount by the Federal Reserve Bank, must not exceed ninety days, exclusive of days of grace, except that agricultural or livestock paper may be rediscounted with maturities not exceeding nine months. This

requirement assures the holding of liquid paper by the Reserve Banks and guards against the dangerous practice of holding in a bank portfolio frozen credits in the form of paper which cannot be realized upon within a short period of time.

The regulations of the Federal Reserve Board governing eligibility are very clear. They are as follows:

1. It must be a negotiable note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in bonds, or notes of the United States, and the name of a party to such transaction must appear upon it as maker, drawer, acceptor, or indorser.
2. It must not be a note, draft, or bill of exchange the proceeds of which have been or are to be advanced or loaned to some other borrower, except that paper of co-operative marketing associations composed of producers of agricultural products is deemed to have been issued or drawn for an agricultural purpose, if the proceeds thereof have been or are to be
   - (a) Advanced by such association to any members thereof for an agricultural purpose, or
   - (b) Used by such association in making payments to any members thereof on account of agricultural products delivered by such members to the association, or
   - (c) Used by such association to meet expenditures incurred or to be incurred by the association in connection with the grading, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members.
3. It must not be a note, draft or bill of exchange the pro-

ceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for any other capital purpose.

4. It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for investments of a purely speculative character.
5. It may be secured by the pledge of goods or collateral of any nature, including paper which is ineligible for discount, provided it (the note, draft, or bill of exchange) is otherwise eligible.

It is very essential to distinguish between commercial and agricultural paper because of the different periods of maturity allowed each class of paper. That there should be any confusion may sound rather unlikely but it sometimes occurs. A farmer's note given for the purchase of articles or commodities to be used in agricultural purposes is agricultural paper; but the purchase and sale of agricultural products is a commercial and not an agricultural transaction.

All paper offered for rediscount must be negotiable, not only in order to pass title to the Federal Reserve Bank, but because the member bank offering the paper must indorse all such paper and consequently assume the responsibilities of an indorser upon negotiable paper.

It is clearly set out by the act and the regulations that paper, the proceeds of which have been used for permanent or fixed investments, or for speculative purposes is not eligible for rediscount. Paper issued for trading in stocks and bonds is not eligible, unless such paper is drawn for the purpose of carrying or trading in bonds and notes of the United States.

One of the important services of the Federal Reserve System has been its emphasis on the distinction between commercial credit and investment credit. This idea is permeating

bank and commercial credit departments everywhere and tending to a stabilization of credit practice.

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CHAPTER XXIX

THE COMMERCIAL PAPER MARKET AND THE NOTE BROKER

The Exchange of Commercial Paper.—No credit manager would find his equipment complete without a knowledge of the relationship of the note broker to the credit standing of his customers. The following statement has been prepared in order to make it possible to evaluate the credit standing of a customer who is borrowing through note brokers.

In many cases, large enterprises find that individual banks are not in a position to take care of their credit needs. The reason may be that the bank does not find it advisable to extend the amount desired; or the refusal may be due to legal limits which prohibit national banks and some of the state banks from lending to one borrower more than one-tenth of the capital and surplus of the bank. Those business firms which cannot obtain necessary credit from their banks must seek other methods of borrowing. In such a situation the note broker finds himself an important factor in the credit chain, for he acts as an intermediary between the firm needing more funds and banks (perhaps in distant parts of the country) which have idle funds for profitable investment. For example, the borrowing house, perhaps one of the large packers, might sell in the "open market" several hundred thousand dollars' worth of promises to pay, running for three, six, or nine months, thus inviting the temporary loan of funds for their enterprise, and thus providing adequate employment for funds of banks which are underloaned.

Commercial paper, as the term is used by note brokers and bankers, includes only straight promissory notes arising

out of commercial or business transactions. The note must represent a current transfer of goods in the market and thus be of the self-liquidating type. It becomes commercial paper on the open market when it is transferred from hand to hand through the medium of note holders in the way suggested in the preceding paragraph.

Most brokers prefer paper in denominations of $2,500 or $5,000. This is because there is a broader market for these than for notes of larger denomination for banks capitalized to permit $2,500 investments greatly outnumber those able to invest larger sums. As a rule, the notes mature within six months, and are payable at the bank or at the office of the note broker.

Function of the Note Broker.—The function of the note broker is the distribution of the borrower's paper. He may sell in his local market as long as that market will absorb what he has to offer, thus acting as an intermediary between borrowers and bankers in the same city, or he may feel that he ought to keep his market open in other cities. As the primary economic function of the broker is distribution over a large territory, we find note brokerage houses with branches in all of the trade and financial centers of the country. Lists are kept in these branches of banks, other institutions and individuals in that section of the country having temporary funds to invest. From time to time offering sheets with lists of desirable paper which has come from other sections of the country are sent to these institutions and individuals. Salesmen are also employed who visit the banks and give them an opportunity of purchasing desirable paper. Some banks will make known beforehand to the broker that they desire to buy commercial paper, and will tell him the amount and maturity of the paper they wish. Sometimes they name the company whose paper they desire to purchase. The broker at his first

opportunity furnishes paper which meets the specified requirements.

The note broker was originally merely an intermediary between borrower and lender. He merely undertook to sell the customer's paper in return for a commission. He did not turn over to the customer any money until after the paper was sold. The broker took little or no risk; he did not in any way guarantee the paper. Now, however, the commercial paper houses are quasi-bankers, for they buy outright all the paper they sell. Funds are advanced to borrowers before the paper is sold, and unsold paper is carried by the broker on his own resources. He must necessarily have a large amount of capital, though he employs very little in proportion to his volume of business. It is possible to do a great volume of business on each dollar of capital because of his ability to borrow heavily at certain times. He uses his capital mainly as a basis for credit with the banks, and often borrows from three to six times its amount. He can use his notes as collateral for bank loans up to from 80 to 95 per cent of the face value.

The broker's profits come from the rapid turnover of the business. As the commission charged for buying and selling the notes averages only about ¼ of 1 per cent, or $2.50 per $1,000, the Federal Reserve Board has made the statement, after investigation, that large note brokers sell out their stock from fifty to a hundred and fifty times a year. At the same time the broker's service includes that of underwriting, and he assumes the risks of the sale of the paper and of a changing interest rate.

While there are no authentic figures for the amount of business transacted through the commercial paper houses, various estimates place the figures high. There are now about thirty commercial paper concerns in the United States whose business is national in scope, and about as many more who do principally a local business. There are about 8,000

to 9,000 concerns which have at one time or another sold paper through these note brokers. It is said that in 1920 about $3,000,000,000 worth of paper was handled and that in 1921 the amount was equal to nearly 10 per cent of the loans made by the national banks of the country.

Because the note broker risks his funds and because the paper is mostly single-name, he must make a careful investigation of money market conditions and of the borrowing firm's credit standing before he purchases the company's paper. The firms borrowing through commercial paper brokers must submit financial statements audited by industrial accounting firms and must supply other credit information to the extent required by the broker. Some of the paper houses have elaborate credit departments, and make very careful investigations.

Care is taken that the current ratio is high, that the current assets are of good quality, that insurance is carried on all inventory, and that all other channels of borrowing by the firm are known.

Some types of businesses do not find it easy to sell paper to the note broker. Luxuries, fashional goods; commodities which have a slow turnover; those which fluctuate rapidly in value; and businesses which are new find it difficult to sell paper.

After the paper house has investigated to its satisfaction the credit standing of a firm, it then buys the commercial paper, and offers it for sale to those who have funds to invest. The note broker does not guarantee to the prospective buyer that the paper will be paid at maturity, but he does guarantee that the paper is legally executed. Moreover, the fact that he himself has bought the paper and taken the risk, is a recommendation for it.

The banker is usually allowed a 10-day option on the paper. He actually buys it, but at the end of 10 days (during which time he has investigated the borrowing firm) if he is

dissatisfied, he may return the paper to the note broker. The bank receives the interest for the time it has held the paper. In this transaction, the broker assumes new risks—those of having the paper turned back to him, and of abuse of the option privilege of the bank.

Advantages of the Note Brokerage System from the Credit Point of View.—Because the United States is a country large in area and varied in industry, different sections of the country at a given time show different conditions economically and financially. Credit needs of the agricultural south and west differ from those of the industrial north and east. At one time credit is needed in the south to move the cotton crop; at another it is needed in the middle west to move the wheat; again, it is needed to aid the manufacturing industries of the east. The banking facilities of one section cannot always provide all the credit needs of the section. In order to supply the necessary additional credit, our financial system must be flexible, and capital must be able to be transferred quickly from one section of the country to another. This quick transfer of funds is brought about through the open discount market, and is perhaps the most important advantage of the note brokerage system. Through it, capital may be quickly moved from places where it is relatively abundant to places where it is relatively scarce. Sections where the greatest need is felt may borrow funds from sections which have an over-supply of credit. Thus, through the note broker, our capital supply is made mobile, and flexible, and the capital resources of various communities are economically utilized to aid other communities.

A second general advantage of the note brokerage system is the equalization in the rate of interest which it brings about. This is very closely connected with the distribution of capital to meet needs of different sections. Because the demand for

capital varies in different sections of the country, the rate of interest will tend also to vary. Where the demand for money is active, the interest rate will be high. Through the note broker, a borrower in an active section can borrow at lower rates by selling paper in another section of the country. This tends to decrease demand in the active section, with a consequent drop in rate. Thus, because the business man can, through the note broker, borrow in the cheapest market, the general rate of interest tends to equal the lower rate, and interest rates tend to uniformity throughout the country.

The position of the borrower is strengthened because of the additional avenue of credit laid open to him at a rate consistent with general market conditions. The balance of twenty per cent customarily required by a bank of its borrowers is not required by the broker. If a large firm were compelled to make all of its loans through banks, legal restrictions would require many bank accounts with the correspondingly heavy balance requirements, making the cost of credit above that of borrowing through brokers. The ability to sell through brokers is in itself a recommendation as to credit standing.

The banker finds the note broker useful, for when he has surplus funds available, he may buy commercial paper and put his funds to use, instead of lending them to local borrowers to be used for less essential or less secure enterprises. The note broker also aids in keeping the resources of the bank in a liquid form, for they may be distributed widely as to territory and the kind of transactions from which the paper originated. The maturity of the paper can be arranged to suit the needs of the bank. The bank is not put in an embarrassing position by a request for renewal on the part of one of its personal customers.

Disadvantages of the Note Brokerage System.—As long as the open market will absorb the notes of borrowing con-

cerns, as long as banks have idle funds to invest in commercial paper, the commercial paper house performs an important function in the financial world. As soon, however, as money becomes a little tight, and banks do not buy as heavily, but keep their funds in reserve, the influence of the note broker is weakened. If a firm cannot sell its notes through the note broker, there is nothing left for it to do but appeal to its banker. Perhaps the firm, thinking that sufficient funds could be obtained through the open market, has not kept all of its lines open at the bank. This makes a difficult problem for the bank to solve. The note brokers, then, while they perform an important economic function, cannot hold up during the periods of depression as well as can the banks. The burden of furnishing credit at such a time falls back on the banking institutions of the country.

Another general disadvantage is the overexpansion of business which is sometimes encouraged by the system. If the note broker is in communication with a bank which wishes to invest in good commercial paper, and he has not in his possession the paper which will meet the need, he may approach various of his borrowing customers and tell them of the opportunity for obtaining additional funds. This is a temptation which business houses sometimes cannot resist, with the result that the borrowed money may be used in expansion which is not justified, and which will lead the business to ruin.

The failure of the open market in time of depression makes a decided hardship on the borrower, for he must appeal to his bank for help, and if he has failed to keep his lines open, the necessary funds may not be forthcoming. Banks have always tried to stand by their customers during "hard times," but the note broker affords no such help during trying periods as do the banks.

A firm which borrows through the open market must expose the minutest details of the company's affairs to credit

agencies and credit managers. This is inconvenient and often unpleasant, and may result in injury to credit standing through unwarranted rumors which may be circulated. While the firm which borrows from its bank knows that its financial condition will be held in strict confidence, the condition of the firm which borrows from the note broker is open to the world, so to speak.

The competition among the brokers, and the availability of easy money markets tend to decrease the bank's rate of interest on loans. Commercial paper brings a lower rate of interest than straight loans to customers.[1] The open market works a hardship on borrowers who have not met the bank's requirement and who can get no further accommodation from the note broker, and then turn to the banker and expect him to carry them over the tight period.

Concluding Estimate.—On the whole, the commercial paper houses have been conducted on a highly efficient and sound basis. There are, however, certain correctives proposed, the purpose of which are to increase the efficiency of the system. The commercial paper houses have never been subjected to any legislation. It has been proposed that there be a central agency where all commercial paper must be registered. This would help to do away with the evil of excessive amounts of paper of one firm—an evil which helped to cause the failure of the H. B. Claflin Company of New York. The movement for registration has not met with great success.

Borrowers' statements should be very carefully audited, and their financial condition should be very thoroughly investigated. This is a very positive way by which weaknesses of the system may be overcome.

If the banker and the broker cooperated more closely, there would be less overexpansion, less misunderstanding between

[1] Phillips, *Bank Credit,* Chap. 16.

banker and customer; in fact, the whole financial system would benefit by such action on the part of two important links in the credit chain.

In spite of the weaknesses and disadvantages of the system of borrowing through note brokers its advantages are numerous enough for its justification. As a means of distributing capital, as a means of equalizing the rate of interest, as a means of providing funds for business firms and forms of investment for banks, its economic usefulness is evident. The borrower should never consider the open market as a permanent means of obtaining funds. If the open market is used under certain conditions, and if cordial relations are maintained with the bank, there are times when both the bank and borrower will profit by its use. Used judiciously, and with the cooperation of the bank, the note brokerage system has an important place in our financial and economic scheme. Used to an extreme, it can naturally injure this scheme.

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CHAPTER XXX

FACTORING AND THE DISCOUNTING OF RECEIVABLES

Marginal Credit Demands.—The discussion of the bases upon which credit is granted both by banks and by commercial houses has indicated the limits which face the average business organization in its attempt to get under way. Proper relations between owned and borrowed capital may not always be present in an enterprise which deserves help of some kind. The old "two to one" relation may be entirely absent at a given moment yet all the innate possibilities of success may be present. Earning power may be visible and yet banks may not be justified in extending a loan.

It is in a situation of this kind that a business organization must find other means of financing its operations. Two important methods of securing working capital under these circumstances are through factoring, and through selling accounts receivable. Factoring has to do with the supplying of capital on the basis of the goods produced and the distribution of those goods; while selling open accounts goes a step farther, and has to do with the borrowing of money on the security of open accounts.

Factoring and Its Functions.—By the time a new business has its plant and its machinery, often a large part of the original investment has been spent. In order to begin and to continue operations, funds must be had to pay for raw materials, labor, and distribution. The firm may be able to turn out some product, but the working capital left after plant and machinery have been secured, is not sufficient to carry the

business over the period from production to payment of accounts. It is a matter of great importance in such a case whether the proceeds of sales may be counted on as being paid exactly at maturity. If accounts owing to the firm are not paid, the firm cannot pay its own accounts, and its credit standing is placed in jeopardy. Some means for supplying this necessary working capital must be found.

In such a situation factoring becomes a vital element. The factor, on the basis of goods shipped from the mill, rather than upon the current ratio of assets and liabilities of the business as a whole, places himself in a position where he allows the borrower to draw on him for a percentage, possibly 50% of the value of the goods as they are shipped from the factory. Thus the manufacturer has immediately available money to replenish his stock of raw materials instead of having to wait for it until his customers pay him at the end of their terms.

Under this plan, and without depriving his customer of the benefits of credit, the manufacturer is placed in a position to do practically a cash business, thereby "facilitating and increasing production, accelerating rate of turnover, increasing volume of sales, and so producing a larger net result on actual capital invested." [1]

There are other benefits accruing to the manufacturer as a result of the practice of factoring. The factor relieves the manufacturer of all problems connected with the distribution of the merchandise—production and selling are left to the manufacturer; collection and credits are delegated to the factor. The manufacturer is relieved of all financial worries; he is able to concentrate on the production of goods.

The factor has a specialized department of credit and collections and assumes all credit risk. He accepts this re-

[1] Goldwasser: "The Factor, the Bank and the Factored Account," in *Bulletin of Robert Morris Associates*, October, 1922.

sponsibility with the knowledge that experience along this line will enable him to effect settements more promptly and with less friction than the manufacturer himself. Furthermore, the factor is engaged in performing this same function for a number of individuals and can take advantage of a more economical organization. The manufacturer reports orders to the factor, just as he would to his own credit department; when the orders are approved, shipments go out. Invoices are rendered payable to the factor. Proceeds are made available at once by this "merchandise banker," as the factor has been called.

The progressive factor is able to aid his client by giving information about business conditions in general, conditions in the particular industry, in world markets, etc. The factor, because of his larger field of service is often in a position to get information which the manufacturer might not otherwise be able to procure.

The factor's charge for this service is a percentage on the volume of business he handles—possibly three, four, or five per cent above the bank rate. Out of this percentage he pays for his office, storage space, insurance, light, heat, power, telephone, deliveries, bookkeeping, and credit and collection facilities, all of which are highly specialized.

As the profits of the factory accumulate, and are put back into the business, it is no longer necessary to secure loans through a factored account. However, some firms prefer to pay the charge of the factor, and retain his services. This is partly due to sentiment and the fact that the factor has meant prosperity in the past; and partly due to the fact that the factor separates the manufacturer from financial worries, including the assumption of all credit risk, so that the manufacturer may concentrate on the production of goods. If the manufacturer can turn his stock rapidly, he more than makes up for the cost of factoring. Factoring has been found more

desirable in business connected with textiles than any other, because of the seasonal character of the business which requires manufacture many months before the sale of the product, and the necessity of anticipating purchases of raw materials thus intensifying the problems of credit and financing.

Selling Open Accounts.—A firm which needs working capital sometimes sells, or assigns, to a bank or a discount company, its accounts receivable. The receivable or discount company provides a means of rediscounting open accounts which are at the time intangible, but which are usually good assets.

The usual method of procedure in selling an open account is for a discount company to take from its customer an assignment of a certain amount of its best open accounts, we may say, $100,000. For this the merchant is paid in cash, 77% or $77,000. Three per cent of this $100,000 is set aside by the discount company as a reserve to cover the credit company's charges; the remaining $20,000 of accounts is a reserve, held by the discount company as collateral or margin to secure them against possible losses, or failure to collect. The merchant gives a promissory note for the whole amount of $100,000 and finally receives that amount in cash, if all the collections are made. In the case of non-collection, the non-collection accounts are deducted and returned to the merchant plus the amount actually collected. The usual charges made by the discounting company are 1/25 of 1% per day on the face amount of each account from date of purchase by the credit company until date of payment to the credit company, plus a flat charge of $5 per $1,000 on the first $100,000 during a stipulated period of perhaps twelve months.

Notification and Non-notification Plans.—Open accounts are assigned under the notification plan where notice of the

assignment is sent to all debtors whose accounts have been assigned, with the request that payment be made through the receivable company; or under the non-notification plan, where such notice is not given, and the debtors and creditors of the firm do not know that the accounts have been assigned.

The notification plan, as a result of customers being informed of the sale of accounts, injures the business reputation of the merchant, while it benefits no one except the banker or discount company, which collects accounts directly from the debtors without any regard or notice to creditors. It is claimed that notification lessens the opportunity for dishonest merchants to mislead creditors as to the true status of their financial condition. On the other hand, there seems to be no more reason for notifying creditors than there is when a merchant borrows money on bills of lading or when he discounts a customer's notes and acceptances.

Open accounts are also assigned under the non-notification plan; the merchant may agree to apply directly all receipts to the reduction of his loan, or he may use the money and assign more accounts of equal value. Non-notification relies upon the honesty, business and integrity of the borrowing firm; it avoids friction with customers—by preserving contact between customer and seller, instead of allowing business to be conducted through a third party.

In certain parts of the United States there has been quite a lively controversy on at different times between certain banking and factoring interests, and organized representation of mercantile credit interests about laws governing recordation of assignment agreements in connection with accounts receivable. There has doubtless been much mercantile credit extended on the strength of financial statements that did not reveal the fact that accounts receivable were pledged or in any way hypothecated. There can be little doubt but that a uniform law in the several states requiring the recordation

of contracts of assignment on accounts receivable would be a step in the right direction. Certain provinces in Canada have already enacted a law of this kind which provides that every assignment or pledge of book accounts must be registered in the office of the registrar of the County Court within which the assignor carries on his business, within five days from making the assignment. Failure to comply with the requirements of this law renders the assignment void as against parties whose interests are prejudiced thereby. This is a feature of legislation yet to be developed in the United States.

Classification of Receivable Business.—Mr. A. E. Duncan [2] divides the receivable business into four parts:

1. The open accounts receivable, and an occasional loan on merchandise awaiting conversion into open accounts.
2. Installment sales contracts on household appliances.
3. Automobile storage paper covering new cars sold by the manufacturer to the dealer awaiting resale to consumer.
4. Retail time sales paper of the automobile to the ultimate consumer.

Although discount companies date back to the early money lenders, the greatest impetus has been given them in recent years, due to the enormous volume of goods sold and payments made (especially household appliances and automobiles) on the installment plan. The automobile industry, particularly, has necessitated financing on a large scale, and financing in accordance with the necessity of accepting time payments. Credit companies in many cases are financing the sale of new cars at wholesale from the factory to the dealer. The dealer is required to pay about 15% of the wholesale price plus freight, and to give an acceptance for the balance. The con-

[2] Chairman of the Board, Commercial Credit Co., Baltimore, Md., in American Bankers' Association Proceedings, 1923.

sumer pays by installments, and the credit company, after checking the consumer's credit, advances 100% on the secured note with a lien upon the car, given by the purchaser.

There are hundreds of companies in the United States seeking loans on accounts receivable in order to have necessary working capital. Many of these do not satisfy the requirements of the bank investigators, and are refused bank loans. This does not necessarily mean that they are not good credit risks. These are the firms which the discount companies are called upon to finance.

As far as using open accounts as security for loans is concerned, it is said that the trade acceptance and promissory note are merely "open accounts closed." Often, owing to the nature of the business or to custom, an open account is the best method for extending credit. If loans may be obtained on the basis of the trade acceptance, which is the open account closed into a note, it seems that loans ought to be obtainable on the basis of the open account. There is no difference in basic principle between the two kinds of credit.

The interest rate on discounted open accounts is higher than on ordinary loans. This is because the security is not regarded as very high class. A merchant in a strong position can borrow directly from his bank, and is not forced to use the much more expensive method of the discount company. However, there are cases where the cash discount rate may exceed even the high rate of interest on receivables, and it is wise for the merchant to pay the interest, and have the money to take advantage of the discount.

Relation of Receivable Companies to Commercial Banks.—This practice of discounting receivables will illustrate the dependence of every part of the credit chain on every other part. Although the commercial bank regards discounting of receivables with disfavor, still "ultimately the commercial bank

itself supplies the money which is passed on through this new type of financial middleman to the borrower whose credit is not good enough to enable a direct loan to be secured."[3]

There are times when a firm must have additional working capital, and cannot secure a loan through the bank. It is in this situation that the factor and the discount company play their part in financing, and while there are objections to the practices of both, still they have an important place and function in the general economic scheme of our industrial world, in the particular situations to which they apply.

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[3] Duncan, A. E., "Receivable Companies," in American Bankers' Association Proceedings, 1923.

CHAPTER XXXI

FOREIGN CREDIT

Distance and the Credit Relation.—The development of transportation facilities and the widening of markets have resulted in the growth of commerce between nations and in the economic interdependence of all parts of the earth. International trade has become a distinct and important branch of business.

Trade between nations is in reality carried on between individuals. The fact that one debtor is a thousand or two thousand miles farther away from the creditor than is another debtor ought not to make great differences in the manner of doing business. Under ordinary circumstances, however, such differences do arise. Distance is not entirely to blame, but it is distance which makes the transactions commerce between *nations*, and international trade gives rise to different sets of laws, to different standards of business, to different monetary systems and credit documents.

It is not within the scope of this volume to include an explanation of the theory of international trade or of the intricacies of international exchange, but merely to point out some of the problems connected with them from the standpoint of the credit situation.

Foreign commerce is carried on principally through credit. Credit is even more necessary here than in domestic transactions. In the long run, a country's exports and imports tend to balance each other. There is as little actual transportation of gold as is possible. This is, of course, due to the inconvenience caused by transportation, to the expense, and to the loss of interest during the time the gold is in transit. So a

country's debts to other countries (including debts due both to transfer of commodities, and also to the "invisible items" of exchange) tend to be offset by that country's credits. In the case of individual transactions, banks keep balances with banks in other countries, and through these, money owed is paid, and money due is collected—with the result that actual transfer of gold is reduced to a minimum.

The various monetary systems prevalent throughout the world further complicate trade relations between countries. When business is transacted with an English manufacturer, the value of the dollar in terms of the pound sterling must be taken into consideration. When exchange is "at par," the pound is worth 4.866 times the American dollar. But trade conditions are constantly changing, and exchange is rarely at par. The price of foreign exchange depends upon a country's balance of debit or credit, and so is always fluctuating. Many times fluctuating currencies affect seriously the profits of buyer and seller and tend to encourage the customer to gamble on the fluctuations of exchange.

If credit is necessary in the domestic exchange of commodities, it is easy to see how much more necessary it is to the conduct of business between individuals of different countries.

The exporter benefits by the disposal of a greater quantity of goods than would be possible on a cash basis and is able to secure greater working capital by discounting foreign drafts. He can keep his factory running more regularly than when dependent upon domestic demands which are oftentimes seasonal.

The importer is enabled to keep in a liquid form investments which would otherwise be tied up for months before merchandise could be turned into cash; he can avoid higher costs which would be necessary if he had to pay high local interest rates in order to pay cash; and he can transact a larger

business in proportion to his invested capital than would be possible on a cash basis.

Special Sources of Foreign Credit Information.—Credits abroad can not be made as safe, as exact, and as scientific as they are in this country. Though the very factor of distance eliminates many who would otherwise be undesirable applicants for credit, the factors of time and distance create some difficulties. New sources of information must be sought out in order that the sale to a foreign buyer may be entirely satisfactory.

In conducting an export business, a firm wants steady customers, who repeat orders continuously for years, and whose every order is a basis for another. In order to accomplish this, the foreign credit manager must of necessity study the nations of the earth, their peoples, their commerce, their ways of doing business. He must know intimately the markets of Africa, the Far East, Russia and India. He must know geography. A knowledge of language is often a great aid in understanding other peoples, and their customs, and often establishes a contact to be gained in no other way. The credit man must know about ocean shipping, marine insurance, international banking and exchange.

Sources of information must be developed in such a way that he can get the information which he needs. For instance, the foreign credit man ought to know at the time he receives an order whether or not the customer can buy wisely at the rate of exchange then prevalent, and he ought to demand that the customer cover his exchange position at the time that he places the order. There is no need to allow the foreign customer to use the capital of the seller for a gamble as to the possible fluctuation in exchange.

Again, it is often difficult to get a complete financial state-

ment from a foreigner, for in many countries that is not a part of credit information.

The foreign customer is generally willing to give a list of mercantile houses in the United States from whom he has purchased. This is one way of getting credit information, though it is not always very valuable.

Special sources of information include the National Association of Manufacturers, the mercantile agencies, American Express Export Department, the American Exporter, large banks of the large cities, the Commercial Intelligence Division of the Government Bureau of Domestic and Foreign Commerce, and the Foreign Credit Interchange Bureau of the National Association of Credit Men.

The government Commercial Intelligence Division bases its information on reports of the representatives of the Departments of State and Commerce, most of whom are stationed in foreign countries and whose information is first-hand. From the World Trade directory, there are compiled trade lists, which may be obtained upon request. During 1921, the Bureau furnished 100,000 trade lists.

The Foreign Credit Interchange Bureau of the National Association of Credit Men has been developed on the same plan that ledger interchange in connection with domestic business has been used. It is a non-profit making organization which gathers information from those who sell to foreign customers and gets larger experience for buyers in various parts of the world. A customer can, by giving information which he already possesses, and pooling it with the rest, receive the benefits of the pooled information already gathered concerning particular accounts. This bureau has been in operation since the middle of September, 1919.

Credit Documents in the Foreign Credit Relation.—Foreign buying and selling creates a need for various methods of

handling such transactions. Sometimes cash is sent with the order, or the buyer is required to pay for merchandise before the shipping documents are surrendered. In many cases a system of open credits is used, which is equivalent to the open account in domestic transactions, and is based on the confidence of the seller in the buyer, which induces him to deliver merchandise without documentary acknowledgment of obligation.

The usual method of payment is through bills of exchange (drafts) drawn on the importer, or drawn on a banker under authority of commercial letters of credit. The importer arranges with his bank to allow the exporter to draw a bill of exchange on the bank at a certain time and under certain conditions. The "letter of credit" explaining conditions, is sent to the exporter and under the authority of this letter the exporter may at once receive his money by drawing a bill of exchange on his customer's bank and having it discounted at his own bank. The letter of credit merely acts as an assurance to the exporter and the discounting bank that bills of exchange will be honored.

References

Edwards, George W. Foreign Commercial Credits. New York, McGraw-Hill Book Co., 1922.

Ward, Wilbert. American Commercial Credits. New York, Ronald Press Co., 1922.

PROBLEMS

NOTE: The problems here given are grouped under the five PARTS into which the text is divided. It is not feasible, however, to distribute them to individual chapters, inasmuch as credit questions as they come to the credit manager's desk almost invariably involve more than one credit principle. In fact, practically all of the problems which follow bring into play matters discussed in more than one PART.

Part I

I. A. P. Thompson, of Antonville, Illinois, decides to go into the retail shoe business in a town of five thousand people located in a prosperous farming community. Thompson has been a salesman for a wholesale house for six years. Previous to that he was a retail shoe clerk for five years. He has enough money to pay for one-half of his original stock and the first month's rent. As he goes on he sees that he has bought too heavily of merchandise suitable for his town trade and too little of farm trade stock. While he is applying for further credit, he finds that the only way he can keep his present desirable location is to purchase the land and building he now occupies. This takes one thousand dollars of the money he was going to use as a first payment on the new merchandise and a relative loans him six thousand more. Instead of paying rent he now makes monthly payments on the property of twice the amount of his former rent.

1. What is the economic justification, other than that of private gain, of the loan of six thousand dollars to buy property?
2. What is the economic justification of the extension of credit by the wholesale house in the purchase of shoes by the retailer?
3. What economic problems must be faced by the credit manager of the wholesaler before granting further credit?
4. Is the credit granted the retail shoe dealer wealth in itself?
5. What would be the result if credit were considered wealth in this transaction?

II. Using the facts given in Problem I, answer the following questions:

1. What kind of credit is that granted by the wholesale house? By the relative?
2. How may the two kinds of credit be distinguished?

3. In the situation indicated is there any chance for the two types of credit to be confused. Explain.
4. If Thompson should sell some of his shoes on the basis that they were to be paid for on the first of the month, what kind of credit would be granted?
5. Thompson bought $200 worth of supplies for his repair department. His bank account was low, so he borrowed $300 from the bank. What kind of credit was this? (Note: The salesman from the wholesale house called. He seemed to be better informed than the average salesman, so he asked him a number of questions which follow:)
6. How many people handle these shoes before the retailer gets them?
7. Is credit extended for each transfer?
8. If one fails to pay what happens?
9. What is the position of the bank in relation to the credit chain?
10. From what source should the money for payments on the store building come in order to keep the business on a sound basis?

III. After using various sources of information the following facts were available concerning a certain risk:

C. C. Carson, age 47. Ten years retail salesman. Divorced. Five years successful retail grocer before becoming salesman for a canning company. Good health. One fire while retail grocer. Established present location nine months as retail grocer. Results of five years' successful operation invested in real estate. Net worth in business alone $2,750. Trade reports good. Officer in Retail Grocers' Association. Drives Cadillac sedan. Spends more time in store than any of his clerks. Statement shows $1,000 Liberty Bonds. Trade center moving two or three blocks away. Beginning to extend credit to meet competition of "cash and carry" chain store. Bank reports him satisfactory. Owns a number of shares of stock considered speculative. Paying some of the expenses of a nephew in college. Sales increasing steadily the last three months. Partial crop failure in community.

1. Classify the information as to its bearing on internal factors such as character, capacity and capital and on external conditions affecting the basis of credit.

IV. A. L. Simpson is putting in a general store in a town of 6,000 people in Central Kansas. He has decided that the departments are to be as follows:

Groceries, Meat, Hardware and Paint, Men's Ready to Wear, Women's Ready to Wear, Millinery, Shoes, Dry Goods and Notions.

He is planning his budget carefully and has asked you to indicate the terms he can probably expect in each line. You work out the amounts which

must be paid on certain dates. He wants further explanation, and you list each department, giving customary terms and the reasons for the length and character of the terms. What did you give him? He is also interested in cash discounts. What figures did you set up in order to show him the amount of his savings by taking advantage of the cash discounts?

V. Simpson's general store prospers. What credit instrument will undoubtedly represent the majority of his credit transactions? How many copies of this particular type of record will there be available? If Simpson decides to put in a farm machinery department and sells on a credit basis, what new form of credit instrument will probably be used? Simpson decides to incorporate and allow a friend to participate in the ownership of his business. By what kind of a document will this interest be represented? Will it be a credit instrument? Later he decides to put up a new building. He raises money by issuing bonds. Would these bonds be credit instruments? He pays for his bills each month by check. In which class of credit instruments does the check belong? He decides to make a buying trip thru the east. Write up the letter of credit which his bank gave him.

VI. Which of the following statements are correct:

1. In order to be negotiable a credit instrument must reveal a conditional promise to pay.
2. In a negotiable credit instrument where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable.
3. The validity or negotiability of a credit instrument is affected if it is not dated.
4. A consideration is not necessary for a negotiable instrument.
5. A telephone conversation will serve to protect a draft.
6. A draft is a document of title.
7. An order bill may be negotiated by delivery where, by the terms of the bill, the carrier undertakes to deliver the goods to the order of a specified person and such person or a subsequent indorser has indorsed it in blank.
8. A contract to sell and a sale are not synonymous under the Uniform Sales Act.
9. The terms "dishonor" and "protest" are the same under the Negotiable Instruments Law.
10. An order, until it has been acknowledged in writing, shipment of goods, or otherwise, is subject to cancellation.

Part II

I. The Black and Brown Paper Company have about twenty thousand accounts on their books. Some of their customers buy only $30 per month

while others buy $6,000 to $8,000 per month. Ten people have been doing all the work in the credit department during the last few years. Only about 7% of all the customers have been seen on a personal interview and many of them only once in the time of their period as customers. Losses have averaged the customary amount in this line of business. In determining the policies for the new year one of the questions to be decided is the addition of another high-grade credit man which will make possible the use of personal interviews to a greater extent both in the office and on the territory. As credit manager, what figures regarding sales, business turned down, losses, etc., would you present to justify the additional expense? What arguments concerning the importance of the personal interview would you advance? What particular items of information not now readily available do you think would be made useful to the house?

II. The head of your firm has been elected president of the local association of credit men, representing most of the wholesalers and manufacturers of a community of 200,000 people. Inasmuch as you were at one time assistant secretary of another association, he asks you to suggest a program of activity for the year which will serve to accomplish the purposes of the organization. State in detail your plan as to meetings, committees, and things to be done.

Imagine yourself the president of a retail merchants' association. What fundamental elements of that organization do you find in good working order? How may you improve this activity? In what way would your program differ from the situation just preceding?

On what basis would you select the legitimate activities of a trade association credit bureau with which you are also associated?

III. The Everwear Shoe Company, with four stores in the retail district of a large city, submits the following figures for three years' operations:

	Feb. 28, 1922	Feb. 28, 1923	Feb. 28, 1924
Quick Assets	$ 556,606	$ 555,042	$ 830,114
Fixed Assets per Statement	215,840	417,068	485,516
Current Liabilities	275,472	296,414	490,256
Total Liabilities	275,472	307,290	498,412
Net Worth per Statement	496,974	664,420	817,218
Receivables	53,934	65,266	104,320
Merchandise	455,410	481,494	710,820
Annual Sales	1,987,562	2,035,460	2,271,808
Annual Profits	51,122	207,448	180,664

During the last year two new stores have been opened. Work out the ratios for each year, arranging in parallel columns:

Current Liabilities to Quick Assets
Receivables to Merchandise
Total Liabilities to Net Worth
Net Worth to Fixed Assets
Sales to Receivables
Sales to Merchandise
Sales to Fixed Assets
Annual Profits to Net Worth
Annual Profits to Sales

Analyze the results and give your estimate of financial condition. Is the company becoming stronger or weaker?

IV. Does the following statement indicate a good basis for credit?

ASSETS

Cash on Hand and in Bank	$ 200.00
Notes Receivable Secured—Good	339.34
Accounts Receivable—Good	236,741.61
Merchandise (rugs) at Cost or Market (use lowest)	520,428.34
Autos and Trucks	4,805.09
Fixtures and Furniture	7,154.10
Other Personal Property:	
Real Estate	7,092.10
Value of Insurance Policies	7,539.60
Chamber of Commerce Bonds	100.00
Salesman's Advance Expenses	310.00
Deposit on Lease	950.00
Total	$785,660.18

LIABILITIES

Open Accounts Not Due	$150,235.66
Open Accounts Due—Bank Notes and Overdrafts	178,966.10
Salesman's Commission—Accrued	2,994.34
Internal Revenue Tax Payable	7,459.62
Other Liabilities	13,162.90
Capital	391,700.00
Surplus and Undivided Profits	41,141.56
Total	$785,660.18

If you knew that most of the merchandise was rugs and that sales had been falling off for the last six months, what would your answer be?

V. The following statement was dated September 30, 1922, reporting the condition of the E and D Produce Packing Company:

ASSETS

Cash on Hand	$ 1,259.16
Purchase Deposits	4,300.00
Furniture and Fixtures	379.50
Automobile	965.90
Buildings and Structures	187.00
Accounts Receivable	7,635.63
Farm Implements	18.00
Inventory	15,010.78
Contracts	1,773.98
Total	$31,529.95

LIABILITIES

Capital Account	$ 7,000.00
Notes Payable	2,000.00
Deposits on Contracts	6,400.00
Accounts Payable	8,540.00
Surplus and Undivided Profits	7,589.89
Total	$31,529.95

The following statement of the same company was turned in to a mercantile agency on March 31, 1924, giving the financial condition of the same company:

ASSETS

Merchandise	$ 1,855.20	
Accounts receivable	3,017.10	
Cash in bank	10,426.26	
Machinery	3,700.00	
Fixtures	1,008.00	
Real estate	1,426.00	
Other assets—R. R. claims	43,614.95	
Money advanced mdse.—future delivery	2,250.00	$67,297.51

LIABILITIES

Open accounts for mdse.	$ 7,316.79	
Undivided profits due others	4,996.65	$12,313.44
NET WORTH		$54,984.07

Sales the past year to January 1, 1924, $20.617.24
Insurance on mdse., $3,000.00
Insurance on bldgs., $1,500.00
Other information was given as follows:

"Above statement was thought to fairly reflect the condition of the business at that time and is considered for the most part self-explanatory. Cash in bank was confirmed. Later investigation finds them maintaining substantial balance at all times and not to be seekers of credit there.

"It is the opinion of authorities that they have been doing a good volume of business, and that late figures would show some progress made, however, in the absence of same, do not offer in excess of $20,000 as an estimate of net worth for credit purposes."

Trade Opinions

"Their principal purchases are made direct from the growers on a cash basis. The following trade information was received in the local market:

High Credit	Payments	Owe	Comments
$1,460	Slow	$475	$475 past due, fair acct.
			$485 past due 90 days

"One other house consulted reports no recent experience."

Antecedents

"Commenced business Jan. 1, 1922, previous to which time both parties were engaged as buyers and shippers individually for the past ten years at this point. Previous to that were employed by others."

Fire Record

"Clear."

General Remarks

"Those interested appear personally well regarded and considerably experienced and capable in this line. The business is given their close attention and they are thought doing a good volume and making some headway. Prospects appear favorable."

1. Make suggested application of ratio analysis as seems expedient comparing the two statements.
2. What points are brought out by comparison?
3. What points in connection with general information would affect your interpretation of the significance of particular ratios?

VI. The following statement has been copied from the records of an Adjustment Bureau.

> "Minutes of a Conference of Creditors. In re: XYZ Company (Men's Furnishings), 3440 E. Chicago Avenue, Omaha, Nebraska, December 10, 1924. In this conference of creditors seven debtors were represented. Conference called for purpose of submitting to creditors assignment executed by subject on November 30. Investigation shows conditions as follows:
>
> | Assets | | Liabilities | |
> |---|---|---|---|
> | Merchandise .... | $1,430.54 | Approximately ...... | $3,700.00 |
> | Fixtures .... | 234.50 | | |
> | Fixtures on contract costing $2,587.50, equity .... | 165.50 | | |
>
> "This statement was first ever seen by creditors.
>
> "Debtors commenced operations ninety days before on borrowed capital of $1,000. They advise that they did not have any means outside of this borrowed money. They secured a lease on the premises to run 7½ years at a monthly rental of $200.00 and made a deposit of $600.00 as security on the lease. They claim to have spent the balance of the $1,000 as initial payment on fixtures, $165.50, and on miscellaneous expenses, etc. Consequently they had to purchase all of their merchandise on credit. They give the foregoing as the reason for the deficiency and, in addition, state that they drew on the business $33.00 per week each (two partners). They have paid 3 months' rent of $200.00 a month, or $600.00, making a total expense of about $2,000.00.
>
> "They state that their receipts for the period of operations were about $2,000.00, which was used to apply on accounts and pay salaries and expenses.
>
> "It was decided not to force this concern into bankruptcy because subjects had not secured any material gain. The assignment was ratified.
>
> "Relative to the lease, which seemed to have a substantial value, it was reported that the landlord is desirous of securing the return of the premises as he has a tenant who will pay $300.00 a month on a longer lease.
>
> "Creditors attending this conference instructed the Bureau to pay one month's rent of $200.00 to hold lease and attempt to find a purchaser therefor. If, however, the landlord would return the $600.00 deposit then the Bureau was instructed to accept this amount and surrender the lease."

1. Does this situation emphasize the importance of getting financial statements? Why?
2. As one of the large creditors, what would you tell your credit manager on this subject?

Part III

I. The A B Company, a new concern, opened an account with The Minneapolis Salt Products Company on April 21, 1923, the first purchase being for $10.50. Further purchases were made during April to the amount of $50.00. On May 1st an order was placed for a carload of merchandise which would amount to about $300.00. A report was called for from an agency before the order was filed. The report was as follows:

Balance Sheet, March 31, 1923

Assets

Current			
Cash in Bank		$ 73.61	
Petty Cash		54.60	
Accounts Receivable		1,786.50	
(Long) Branch		3.36	
Notes Receivable		4,750.00	
Material and Supplies		4,924.98	
Notes Receivable—Subscribers		10,267.91	$21,860.96
Deferred			
Alteration to Building		$6,772.49	
Organization Expense		9,001.33	
Products		13,652.64	
Prepaid Insurance		830.28	
Deposit		350.00	30,606.74
Fixed			
Land		$9,500.00	
Autos	$6,424.86		
Reserve for Depreciation	348.62	6,076.24	
Small Tools		250.00	
Leasehold		149.67	
Leasehold		250.00	
Customers' Equipment		2,156.50	
Office Equipment		1,661.33	
Electric Fixtures		2,046.64	
Machinery and Equipment		21,544.41	43,634.79
Total			$96,102.49

LIABILITIES

Current		
Notes Payable	$10,412.28	
Trade Acceptances Payable........	2,312.95	
Accounts Payable................	10,141.09	
Contracts Payable................	2,027.95	
Options Payable.................	100.00	
Personal Payable	876.92	$25,871.19
Accrued		
Accrued Payroll.................		791.09
Fixed		
Mortgage Payable................		5,000.00
Capital		
Capital Stock ($500,000 authorized)	$51,670.00	
Subscription	21,180.00	
	$72,850.00	
Less Common Paid on Sale of Stock	12,661.14	60,188.86
Paid in Surplus..................		10.00
Less on Operations (Red.)........	3,661.62	
Loss on Maxwell.................	579.73	
Total Loss (Red.)...............		4,241.35
TOTAL		$96,102.49

The report also stated that a capable man was manager and, although operations had been at a loss, prospects for a profitable business were good.

After some hesitation the order for $300.00 was filled on May 9. Other small orders were filled.

On May 11 a check was received for $50.00 in payment for April business. On June 11 a check was received for $200.00 and on June 20 a check for $154.74, paying the May account in full. June purchases amounted to $342.50 and were paid for on July 26 with a trade acceptance due in 15 days. On August 1 an order was placed for goods amounting to $367.50. This order was passed under protest of the credit manager at the request of the general manager, who had interviewed the manager of the A B Company and was favorably impressed with his personality and capability.

The trade acceptance, given on July 26, was paid when due on August 11. On September 19 two trade acceptances were given for a total of $472.00 in payment of the August business. These were payable,—one-half in 30 days and the other one-half in 45 days. On October 15

a further purchase of $218.22 was allowed by the general manager against the credit manager's protest. The general manager's willingness to extend unmerited credit was due to the promises and strong personality of the manager of the A B Company. On October 19 the first trade acceptance for $237.78 was returned by the bank as uncollectible.

The A B Company was thrown into involuntary bankruptcy on October 24. The claim of the Minneapolis Salt Products Company amounted to $743.32 and was still in the Bankrupt Court on October 17, 1924. The credit manager refused to O. K. the last $675.00 worth of credit extended to the A B Company by the general manager.

1. Does payment of an account when due by a trade acceptance indicate weakening of credit standing when it has not been customary to make payments in this fashion?
2. What points in connection with the statement indicate weakness?
3. What points indicate strength?
4. What suggestion would you make in connection with the relationship between the credit manager and the general manager of this company?
5. What is the fundamental basis for a relationship between the credit department and the general management of a concern?

Part IV

I. The Buy and Sell Company has been a customer of the Merchants Wholesale Dry Goods Company for the past five years. High credit $1500. Never discounted. Always a few days behind but always good. During the past eighteen months payments have become slower and slower. $3000 is now 60 days past due. The ordinary statement and one letter and one telephone call have gone out in hopes of getting payment.

Indicate what was probably said in the letter and on the telephone. Assume that all of your skill as a collector was needed to bring in this money and that you did everything except force payment by legal action. Indicate in detail the series of telephone calls, letters, interviews or other steps in the collection process which you used before you were successful in getting payment.

II. John Swanson, operating a small chain of markets, has been buying from The Kansas City Soap Company for 3 years. It is understood that he is well fixed financially, a very capable man and enjoys an excellent reputation for honesty and integrity. He began as a small buyer, gradually increasing his purchases in line with his increased volume, caused mainly by the increase in population. He has always discounted all bills and the credit manager has no hesitancy in passing on his credit. Lately, however, he has stopped discounting, and on the strength of his

past record we have filled a half-dozen of his orders, the oldest of which is now 30 days past due. (Terms are 2% 10 days, 30 days net.) The collector, who has called twice, was told the first time that check had been mailed. On his second trip they told him that it would be mailed that night. It has not yet been received.

The Board of Trade report shows approximately $8000 extended with only $100 past due. The Kansas City Soap Company has extended him as high as $150, of which $125 is now past due, and they are holding an order for $50.00.

1. Should this order be filled before his past due account is paid or would you demand that account be brought up to date?
2. How would you collect his account and still retain his good-will?

III. The following information has been copied from the records of an adjustment bureau:

"Mr. A. B. Smith, Circle Department Store, Subdivision Center, El Paso.

Assets

Cash in hand	$3,200.00	
Cash in bank	574.50	
Merchandise	8,421.60	
Fixtures and other equipment	1,650.00	$13,846.10

Liabilities

For merchandise—accounts not due but owing	$6,741.70	
Fixtures, etc., about	1,000.00	$ 7,471.70

"Books of account kept daily. Cost records kept. Accounts not sold nor pledged to creditors, banks, finance companies, or others. No claims in attorneys' hands or suits against them. No merchandise on consignment or conditional sale. Business property leased for 5 years $125 per month. Did banking with Southwest Bank and Trust Company. Business in general merchandise. Had previous experience of 10 years with Marshall Field, Chicago, 1921; M. Lewison, Cicero, Illinois, 1923. Carries no life insurance for benefit of business.

"Summary of Profit and Loss: New business. Does not hold land or buildings. Buys principally from local firms. March 11, 1924.

"Meeting of creditors April 7, 1924. New statement was presented as follows:

ASSETS

Merchandise	$ 7,091.42	
Fixtures	486.79	
Equity in fixtures	40.00	$ 7,618.21

LIABILITIES

Approximately	$12,902.47	$12,902.47

"Creditors were advised that to date the Board had been unable to get a line on the subject. None of the creditors knew anything regarding the subject, his antecedents, or were intimately acquainted with him. Final payment 18c on the dollar through bankruptcy proceedings."

1. How do you explain the change in positions as revealed in the statements taking place so suddenly?
2. In what ways do you think the credit managers of the firms selling the department store are to blame?

IV. The customer, whose credit standing was in question owed $1,500.00 overdue, payment of which he was withholding on grounds of dispute in price. Dispute in price arose on deliveries of materials under contract, basing price on rise and fall in market on the particular commodity. A new contract was made cancelling old contract. A new order was submitted to the credit man under new contract for credit approval, approximating $1,000.00. If the order were approved, the total amount involved would greatly exceed the customer's credit limit. If the order were not approved the credit man would cause breach of contract for non-delivery.

1. What is the correct action for the credit man to take?
2. Contract contains clause providing 30-day terms if buyer's credit standing is satisfactory to the seller. Would it, therefore, be permissible under the above circumstances to tender shipment on terms of sight draft against order bill of lading?
3. What action should the credit man take if it were determined that sight draft against order bill of lading was the proper procedure?
4. If buyer refuses to accept shipment except on terms specified in contract, what facts should the credit man be prepared to present to prove buyer's credit standing to be unsatisfactory to seller?
5. Would an unpaid disputed account be sufficient grounds on which to deny further shipments on credit?
6. Suppose the customer produced a statement from his bank showing ample funds to pay for any materials ordered under contract. Would that be sufficient justification for the credit man to make shipment?

7. Suppose buyer, by confidential reports from other creditors, was shown to be in the habit of disputing accounts. Would that have any bearing on the approval of this order?
8. Would it be proper to take agency reports into Court to prove buyer's similar tactics with other creditors? Give reasons. What should be done by a credit man before a sales contract is made with a buyer?
9. Suppose contract provides deliveries over a period of time. Should credit man satisfy himself of buyer's ability to carry out his part of contract in the aggregate, or merely for such shipments as might be owing in any given period created by terms of sale?
10. Suppose it were determined wise to make shipment on terms specified in contract and the account were ultimately lost, due to financial inability of buyer to pay. What responsibility should attach to the credit man for having approved the order?
11. Suppose it were determined not to ship the order on customer's refusal to accept sight draft order bill of lading terms, and buyer sued for breach of contract for non-delivery. What responsibility should attach to the credit man for causing breach of contract?
12. Should the credit man, in your opinion, be capable of properly determining the correct course of action under circumstances like the foregoing?

V. The customer was a moderately successful paint manufacturer selling almost exclusively to a dry-docking company for painting large vessels. He had been buying regularly from the seller for a number of years, purchases approximating an average of about $300.00 per month. Bills were satisfactorily paid according to terms. Seller decided to remove local branch from which purchases were made. Commodity in question was Turpentine Substitute requiring large tank storage facilities. To reship this stock to a distant point would have been quite expensive for the seller. The buyer in question had large tank storage facilities and in this respect was prepared to take over the entire stock, amounting to about $3,000.00. Buyer, however, refused to take this stock (August) unless given December dating, the entire bill to mature on December 31st.

1. What specific things should the credit man determine before approving such delivery on terms proposed?
2. Let us assume that all of the ordinary credit requisites are present and ample to justify the transaction. What precautions should be taken to provide for unforeseen contingencies?

VI. The transaction referred to in the preceding problem actually happened in 1918. When the armistice was signed, greatly affecting ship-building and ship-repairing, sales of this buyer were practically wiped out, precipitating bankruptcy. The credit man discovered buyer had secretly hypothecated to the bank accounts receivable and other assets. Title in

the commodity had been transferred to the buyer at the time transaction was closed.

1. Would the remaining stock of this material be available to apply on the buyer's indebtedness to the seller? What reasoning do you use in arriving at your conclusion?
2. Would the result be different if the material had been transferred on consignment at the time the transaction was made?
3. In addition to a bona fide consignment agreement in such transaction, what further steps are necessary on the part of the credit man to make such a transaction bona fide under above circumstances?
4. Is that necessary in all states?
5. Should a credit man in such a transaction be sure that the stock is adequately covered by fire insurance by either the buyer or the seller?
6. Has the seller any redress against buyer for secret hypothecation of accounts receivable and other assets which were given as a basis for credit?
7. If so, what must he prove?
8. Are there any laws in effect on the subject of false financial statements?
9. Would this transaction come under the purview of such a law?
10. Suppose the financial statement in a case like this were furnished through the United States mails. What course of action would be open to the credit man?
11. In order to prove fraudulent use of mails in connection with a financial statement, what documentary evidence is very essential?
12. Should this evidence be kept and filed by the credit man in all such transactions by mail?

VII. On May 28, 1924, the Cooperative Lumber Company of Portland, Oregon, received application for credit from a building supply house which had recently opened a branch store in a neighboring city. They obtained a report dated October 25, 1923, from R. G. Dun, which read as follows:

> "Brown Building Materials Company (Registered). Sole Owner, John Brown. He is aged 25 and married. Has resided in Portland since the latter part of 1913, the family coming originally from England. He was formerly in employ of brother, who operates as Brown Roofing and Paper Company and commenced on his own account February 1, 1920, and has made progress.
>
> Statements
>
> "At the commencement of the business he claimed a cash capital of $2,500.

Date		Assets	Liabilities	Net Worth
February	1920	$ 2,800.00	$ 1,000.00	$ 1,800.00
May	1921	22,750.00	current	
January	1922	52,591.96	18,842.45	33,749.51
May	1923	124,689.89	49,724.42	74,965.47

"The following unsigned statement from inventory of October 1, 1923: John Brown sole owner.

Assets

Merchandise on hand		$ 78,571.27
Accounts receivable		22,612.18
Cash on hand		180.00
Cash in bank		14,379.46
Trucks		22,500.00
Household		17,000.00
15-year lease—last month's rent paid		33,000.00
		$188,242.91

Liabilities

For merchandise not due	$41,822.85	
Loans from bank	15,000.00	56,822.85
Surplus		$131,420.06

Real Estate

325 A Ave. (residence)	$12,000.00	
Vacant lot Cor. 34th & Lane Sts.	1,100.00	$ 13,100.00
Net Worth		$144,520.06

Insurance on stock $72,000; also carry employer's liability insurance.

General Information

"Those consulted believe that statement as above given is correct from owner's standpoint. It is noted, however, that in the assets he has included his household furnishings as an asset which would be eliminated and the home would be subject to homestead exemptions up to $5,000. A short time ago he sold an apartment house to good advantage and bought a new residence and expended amount stated in fitting and furnishing the place. Is also understood to have recently purchased a new Cadillac passenger car. Those interviewed say that there is no question but what he has made wonderful progress, has from time to time added different depart-

ments, such as electric fixtures, building materials, hardware, plumbers' supplies, etc., and now carries a large up-to-date stock of merchandise. He has a payroll of 51 men. His accounts receivable are considered reasonably good. Has valuable lease on the property occupied. Has two leases, one a fifteen-year lease now running 13½ and recently leased adjoining property for fourteen years. The property is improved with a one-story and two-story brick, the two-story is rented as a hotel and on the rear on A Avenue is a row of two-story brick apartments which he rents; he also sub-rents the stores on the 16th Street frontage that he does not use himself and on the B Street frontage. The property has a frontage of 330 ft. on A, one block frontage on 16th and approximately 150 ft. frontage on B St. Those conferred with say he has a very valuable lease and it has recently been estimated worth $185,000 by reliable real estate men. He gets a good income from the property and has what he considers favorable prospects of securing a 99-year lease on the entire property before his present leases expire. It is also understood that of the liabilities to bank of $15,000, which amount is correct, $10,000 was borrowed to take care of the fourteen-year lease acquired. A few months ago he opened a retail branch in Salem and is said to be doing a good business there.

"He is regarded as a good salesman and an untiring worker, has his business well systematized, and believed to be doing well. It is understood from outside sources that at one time quite an amount was made in outside speculation, which at the time was not altogether approved of, but appears to be giving his undivided attention to his commercial interests now, and while he is in some quarters believed inclined to spread out considerably, he is favorably regarded and his relations at the bank are satisfactory.

"The building he occupies at 329 E. 16th Street is a two-story brick one, with the same character of building at 517 E. 16th Street; a two-story frame building on C Street; brick building in Salem, protected by city fire protection, interior fire extinguishers, night and day watchman, and employees drilled as a fire brigade.

FIRE RECORD

"None.

"Credit was extended and an account opened June 1, 1924. The terms were net—10th of the month following month of delivery. All orders to be given by the branch store were to be confirmed with a written order and signed by the branch manager.

"The first month's purchases amounted to $2,800.00. The account was not paid by July 15 and a telephone request was made for a check, which was promised for the day following. After

waiting two days they were again asked for a check and the excuse was made that they were having trouble in checking invoices. This matter was immediately straightened out and a check again promised for the following day. After waiting two more days the branch manager was again called on the telephone and he said the delay must be in the main office, and that he would call them immediately and ask them to hurry the check up. He called back on the telephone with the statement that the check would be mailed right away. The Company again waited two days, the check not having been received, and the account now being about $3,500.00. The branch manager was called and advised that no more of their orders would be filled until check was received. The check arrived the following morning.

"Their July account, which amounted to $2,000.00, was not paid until August 27, and they gave as their excuse that they had been compelled to discharge their bookkeeper and had been unable to check invoices. The same procedure was necessary to get the check as was used the month before. About this time it was noticed that they were having to file a number of mechanics' liens, which indicated that their collections were not good.

"Their August account amounted to $1,800.00 and was not paid until September 22, after the usual amount of calling on the telephone, and so forth. In September a $1,000.00 limit was placed on the account, and when the branch manager was informed of this he stated that he could not do business on such terms and that he would be compelled to do his buying elsewhere. The Company replied that if he would furnish them with a late statement, and it indicated a healthy condition of the business, they would then be able to say what amount of credit could be extended to him.

"The latter part of October the following statement was received:

Assets	
Bank Account	$ 1,292.81
Cash on Hand	230.00
Accounts Receivable	86,059.94
Real Estate	45,211.54
Merchandise Inventory	125,338.72
Trucks	25,542.01
Furniture and Fixtures	8,377.60
The last year's rent advanced on 15-year lease, buildings on 16th Street, located from A Avenue to B Street and 330 feet deep	33,000.00
Total	$325,052.62

LIABILITIES

Accounts Payable	$123,461.62	
Accounts Payable Contracts	19,793.88	
Notes Payable	35,000.00	
	$178,255.50	
Surplus A/C	146,797.12	
TOTAL	$325,052.62	

Insurance carried $112,000.00
Lease worth approximately $225,000.00

(Signed) BROWN BUILDING MATERIALS COMPANY
Per John Brown

1. How much credit is this firm entitled to?
2. What significant ratios have changed during the period between the two statements?
3. What is the significance of each change?

VIII. Mr. A. J. Stratton, a groceryman, has been doing business with The Eastern Wholesale grocers for years. About ten years ago he went through bankruptcy and settled about 75c on the dollar. He has been getting credit of from $75.00 to $100.00, terms 60 to 90 days. The wholesale company has been holding one order until he pays for the previous one. At present he owes the company $78.00 for an order of October 20 and they have a new order for $73.00 taken on November 24. The company's collector called on him December 5 and asked for a check for the October 20th account and stated that until check had been received the new order was being held. He said to continue holding it until he mailed the check, as he could not pay the collector that day.

The following statement shows condition of Mr. Stratton's business on March 1, 1924:

ASSETS

Cash on hand	$ 400.00	
Cash in bank	1,671.20	
Accounts Receivable	11,780.26	
Merchandise	37,469.64	
Fixtures	7,835.05	
Land and Buildings	18,500.00	
Prepaid Insurance, etc.	1,314.09	
Auto Equipment	2,700.00	$81,670.24

LIABILITIES

Accounts Payable (Merchandise)	$25,704.16	
Notes Payable (Bank, R. E. Loan)	3,500.00	
Notes Payable (Bank)	2,500.00	
Net Worth	49,966.08	$81,670.24

A report made by the Ledger Exchange of an adjustment bureau on March 24, 1924, shows 41 reports: $15,000.00 owing; $3,000.00 past due, with 18 reporting slow and very slow; 5 prompt; 2 accounts inactive; 2 discounts; 1 hold to seven days; 2 demand; 1 bill paid before another is shipped.

1. Shall the order for $73.00 taken on November 24 be shipped before a check is received for $78.00 for the October 20th account?

Part V

I. Mr. John Doe, of the John Doe Company, at 8617 Goodfellow Avenue, Los Angeles, California, went in to his bank and, after presenting the following statement, asked for a line of credit of $2,000.00, unsecured, for business purposes.

He filed the following financial statement:

ASSETS

Cash on Hand and in Bank	$ 922.77
Accounts not due—all good	2,269.83
Accounts over 60 days past due—all good	178.79
Merchandise on Hand	5,000.00
Listed Stocks and Bonds	150.00
Due from Escrow, #769-143 Cal. Trust Co.	1,200.00
Total Quick Assets	$ 9,721.39
Unlisted Stocks and Bonds	200.00
Notes and Accounts Due from Relatives, Employees, etc.	150.00
Real Estate Owned	12,750.00
Machinery and Fixtures	1,300.00
Automobiles and Trucks—Cadillac 1922	2,250.00
TOTAL	$26,371.39

LIABILITIES

Notes and Bills Payable, Due within a year	$ 1,000.00
Open Accounts, not due	2,892.60
Mortgage Payments, due or due within a year	1,215.48
Total Current Liabilities	$ 5,108.08

Mortgages on Real Estate, due after one year	$ 5,398.67
Sub-Total	10,506.75
Net Worth (Capital and Surplus)	15,864.64
TOTAL	$26,371.39

Company carries $2,500.00 fire insurance on buildings; $1,000.00 fire insurance on merchandise. Mr. Doe carries $5,000.00 life insurance policy, payable to his wife; no accident insurance; no workmen's compensation insurance and no automobile liability insurance. None of his assets are pledged except as indicated in the statement. Mr. Doe has endorsed a note as an accommodation signer for the amount of $1,500.00, payable in 12 months. The date of this statement was January 1, 1924.

Mr. Doe wants $2,000.00 in order to repay an item of $1,000.00 incurred by the previous owner of the business and in order to take discount on accounts now due. He expects to pay $500.00 a month from the profits of his business. He opened an account in the name of his company July 7, 1923, coming from the A B Trust and Savings Bank, where he carried a personal account. Their letter to this bank stated that he opened an account with them about a year ago, coming from Detroit, where, the bank stated, he had carried a small routine account three years. In Detroit he was an employee of a large automobile accessory plant. Mr. Doe has a nice appearing store and is apparently aggressive and honest. His average bank balance carried is $1,000.00.

Profit and Loss account appeared as follows:

Expenses		
Cost of Material or Merchandise		$16,813.17
Salaries to Officers and Partners		5,000.00
All Other Operating Expenses		2,517.62
Sub-Total		24,330.79
Net Profit		2,366.64
TOTAL		$26,697.43
Income		
Sales		$26,692.81
From Discounts		4.62
TOTAL		$26,697.43
Add Gross Income	$26,697.43	
Deduct Total Expenses	24,330.79	
Present Surplus		$ 2,366.64

This company is a corporation with an authorized capitalization of $25,000.00 with 250 shares of $100.00 each, 100 of which have been issued. 100% has been paid in on the number issued.

Title to real estate is not in the name of Doe. The business carries two bank accounts. The stocks owned are oil securities of a speculative character. The bonds are Liberty Bonds. The automobile operated is a Cadillac.

When this application came before the loan committee on its first presentation the following questions were asked:

a. Has Mr. Doe had any previous experience in the retail dry goods business?
b. Do you believe the antecedent information specific enough to advance unsecured credit?
c. Why is title to real estate not in name of Doe?
d. Isn't the insurance inadequate?
e. Why should a business of this size carry two bank accounts?
f. What are the details concerning Item 6 on statement—"Due from an escrow"?
g. What are the particulars regarding Mr. Doe's contingent liability of $1,500 on his brother's note?
h. Why is the inventory in round numbers, indicating an estimation rather than actual count?
i. Why does a man of this small net worth speculate in oil by buying 200 Oil and Soakum units?
j. What is the item of $300.00 in Accounts Receivable which does not result from merchandise sold?
k. Why does this man operate a Cadillac with such a small net worth and consequent heavier expense in connection with his car?
l. How can a man operate for a year, doing a credit business, and show no bad debts, losses or depreciation?
m. How can Mr. Doe repay this $2,000.00 loan at the rate of $500.00 a month when his last year's profits were less than $200 00 a month?
n. Isn't it a rather heavy proportion to show out of a net worth of $15,866.64 $16,650.00 invested in slow assets?
o. Why were not trade references and supply houses submitted?
p. Why is a company of this size incorporated?
q. Shouldn't you examine the books of this Company?
r. Do you believe that a merchant of this size, in the neighborhood he is in, is justified in doing a credit business?
s. What kind of a man is Mr. Doe?

What kind of answers would you wish to have in connection with each one of these questions in order to grant the loan?

II. Mr. Richard Blanks has been banking with one of the agencies of the National Bank and Trust Company, Long Branch, N. J., since the early part of 1920, when he went into business for himself, having formerly been in the employ of a wholesale dry goods house where he had a clear record. With an initial capital of $10,000, which he had saved through his years of labor, a general merchandise store was opened up on Montver Street just off Woodland Boulevard. Since opening up his business he has not asked for any loan and has conducted his account satisfactorily, as evidenced by the following average balances:

1920	$10,000
1921	14,000
1922	14,000
1923	12,000
1924	10,000

He is now asking for a $15,000 loan for 90 days with which to pay some of his bills which have become past due, as business has fallen off and collections have been poor. He hopes to repay this from the collection of his accounts receivable as evidenced by his statement which shows:

Assets		Liabilities	
Cash	$ 7,794.48	Accounts Payable	$ 67,230.08
Accounts Receivable	45,577.50	Sundry	8,002.28
Merchandise	126,361.12		
			75,232.36
	179,733.10	Real Estate Mortgage	30,000.00
Real Estate	72,000.00		
Machinery and Fixtures	11,227.60		105,232.36
Autos and Trucks	2,400.00	Net Worth	160,128.34
	$265,360.70		$265,360.70

Operating Figures

Period from 1-1-23 to 12-31-23

Sales	$357,844.00
Net Profit	15,236.00
Withdrawals	0.00

Explanatory Data Re Statement

Accounts —Are small for the major part and represent credit given to customers who have been known for a long period of years and involves only a small part of his business.

MERCHANDISE	—Consists of general department store merchandise and is advised to all be in good condition and not over a year old.
REAL ESTATE	—Stands in his own name and was acquired a year ago for his business. It was originally bought on contract, but later converted into his own name and a large mortgage placed against the property.

BALANCE OF ITEMS—Self-explanatory.

1. Would you make this loan on the basis outlined?

COMPARATIVE FIGURES OF MR. BLANKS' BUSINESS SINCE ORGANIZATION

ASSETS	1920	1921	1922	1923
Cash	$ 3,608	$ 6,420	$ 13,700	$ 7,794
Accounts Receivable	7,232	21,906	29,636	45,578
Merchandise	16,252	45,632	78,326	126,362
TOTAL QUICK ASSETS	27,092	73,958	121,662	179,734
Real Estate	......	......	56,000	72,000
Machinery and Fixtures	2,428	4,228	9,238	13,628
TOTAL ASSETS	$ 29,520	$ 78,186	$186,900	$265,362

LIABILITIES	1920	1921	1922	1923
Accounts Payable	$ 4,324	$ 14,492	$ 39,684	$ 67,230
Reserve for Taxes	......	......	......	8,002
Total Current Liabilities	4,324	14,492	39,684	75,232
Mortgage Debt	......	......	30,000	30,000
Gross Debt	4,324	14,492	69,684	105,232
Surplus or NET WORTH	23,196	63,694	119,216	160,130
TOTAL	$ 27,520	$ 78,186	$188,900	$265,362
Total Quick Assets	27,092	73,958	121,662	179,734
Total Quick Liabilities	4,324	14,492	39,684	75,232
Net Working Capital	22,768	59,466	81,978	104,502
Current Ratio	6.46	5.12	3.06	2.48
Operations Over Period of				
Sales	125,102	205,628	313,786	357,844
Net Profits	16,850	56,926	53,522	15,236
Dividends	......	16,000	......	......
Percentage Profit to Capital	73%	89%	46%	9½%
Percentage Profit to Turnover	13%	28%	17%	4 %

2. With this additional information, is your position on the loan altered?

III. The Omaha Motor Sales Company has maintained an account with the A B Bank since the latter part of 1923, as they started an automobile agency in their neighborhood on the first of the year, handling Paiges and Jewetts. Their paid-in capital at organization amounted to $12,500, since which time they have paid in $2,500 additional. Three men operate this concern, which is a corporation—one having been a salesman for one of the large downtown houses handling these cars; the second a repair man in the same organization; and the third an accountant and auditor for a different automobile house.

They are requesting at this time a loan of $5,000 with which to stock two Paige closed models, as their cars on the floor have been somewhat cut down owing to excellent business. They handle their contracts through the Finance Corporation of Nebraska and average balance has been $2,000 during the life of the account, and all dealings have been satisfactory.

The individuals carry small personal accounts of $100 or $200 and do not claim any outside means. The statement of the Company, as of June 30, 1924, follows:

Assets		Liabilities	
Cash	$ 4,436.28	Accounts Payable	$ 7,032.02
Contracts	11,588.16	Due to Principals	10,000.00
Inventory	30,000.00		
		Total Current	17,032.02
Total Quick	46,024.44		
Furniture and Fixtures	6,000.00		
Deposit on Contracts	10,000.00	Net Worth	44,992.42
Total	$62,024.44	Total	$62,024.44

Operating Statement for 1-1-24 to 6-30-24

Sales		$231,638.84
Cost of Goods	$187,022.28	
Sales and Other Expenses	17,624.14	
Salaries to Principals	12,000.00	216,646.42
Net Profit		$ 14,992.42

Contingent Liability $85,752.28

The loan committee asked the following questions and received in each case the answer given below:

a. Why do they not discount their $11,588.16 in contracts to make up this loan?
Investigation discloses that these were sold upon only 10% down payments and will not be handled by the Finance Corporation. The automobile concern adopted this policy to stimulate sales.

b. What proportion of the Inventory is in used cars?
Inventory shows $10,000 in new cars, consisting of two open Jewetts, one closed Jewett, one open Paige. $16,000 used car valuation—makes and models claimed by the management to be conservatively valued. $4,000 parts and accessories.

c. What are the deposits on the Contract items?
In order to secure this agency the Company had to sign up a contract —on which they made a deposit of $10,000.

d. What are the terms of this contract?
200 cars for the year—50 cars to be taken in the first six months. In the event that they fall down the $10,000 to be forfeited.

e. Why are the Accounts Payable so big, and what do they represent?
This is for the accessories and parts purchased, as all automobiles are bought on sight draft. The Company has become a little bit delinquent in paying these obligations, as they have been hard pressed for funds.

f. What is the amount due to principals represented by?
The individuals have loaned the Company this money from their salaries, and one paid in some outside money which his wife had left to her for use in the business. They would be willing to subrogate this to a bank loan.

With this information, would you grant the loan on an unsecured basis?

IV. Alfred Johnston had an account in the A B National Bank for two years, and during that time took care of it in a business-like manner. At the end of that time he came in to the bank with a trade acceptance amounting to $300.00, payable 30 days after date, accepted by Richard Leighton. He requested that the paper be discounted on the same interest basis as it carried. At the request of an officer of the bank he filled out a report of his financial condition at that time, which read as follows:

INDIVIDUAL OR PARTNERSHIP STATEMENT

NAME: Alfred Johnston BUSINESS: Contractor
ADDRESS: 1836 West Fourth St., Glendale, California.

For the purpose of obtaining credit with you from time to time, . . . I . . . herewith submit the following as being a fair and accurate statement of . . . my . . . financial condition on October 7, 1924.

ASSETS

Cash on hand and in bank	$ 250.00	
Notes Receivable	300.00	
Accounts Receivable	2,000.00	
Salable Merchandise	3,000.00	
TOTAL QUICK ASSETS		$5,550.00

LIABILITIES

Notes Payable, to Banks		
Other Notes Payable		
Open Accounts Payable	$ 300.00	
Chattel Mortgages on 2 trucks, due Dec. 10, 1925	350.00	
TOTAL CURRENT DEBTS		$ 650.00

Real Estate	$ 1,500.00		
Machinery and Tools	200.00		
Other Assets:		Total Liabilities	$ 650.00
Trucks (Autos)	4,300.00	Net Worth	10,900.00
TOTAL	$11,550.00	TOTAL	$11,550.00

Liability as endorser for others: ....none..............
Are any of the above Assets pledged to secure indebtedness? no.
Life Insurance carried: ....$1,000.00................
Payable to: ....wife........................

Fire Insurance on personal property: ....$4,000.00 on buildings....
Do you carry Employers' Liability Insurance? ....yes........
Are any suits or litigation pending either for or against firm?
.... no ....

(Signed) ALFRED JOHNSTON

(Reverse Side)

DESCRIPTION OF REAL ESTATE

LOCATION	IMPROVEMENTS	IN WHOSE NAME IS TITLE HELD	VALUE	MORT. OR LIEN
Lot #135 Torrey plot, Ashton St., Glendale	None	Mine	$1,500	None

Description of Notes and Accounts Receivable

Promissory note due October 30, 1924, made by John Wilson, endorsed by Everett Jones. Accounts receivable—payment for work and material.

No time was given for further investigation, and it was a question of losing the deal and possibly the patronage of the customer. Discrepancies in presentation of statement are actual.

1. What should be done?
2. What questions would you like to ask about the items in this particular statement before making your decision in the affirmative? Why?
3. What further information would you ask other than revealed in the financial statement before discounting this paper?

V. A salesman for a building material concern turned in an order from J. Jones, who claimed to be a contractor, saying that Mr. Jones would like a line of credit amounting to $2,000. The salesman's report indicated his address and bank connections and the fact that he formerly came from Salt Lake City, where he gave four trade references. He had a building job where he expected to use the material. He gave the location of the property, together with the name of the architect. He had just come to Los Angeles, having been in the city only three months. This was his first job. No other purchases had been made in the city as yet. He planned to build a home for himself as soon as he finished his first job.

The references indicated that, in one case, he had accounts for over three years never amounting to over $250.00, which he had always paid according to agreement or contract. Another reference said that he had had accounts with them several times amounting to not over $175.00. He paid promptly the first two or three times, but the last account had been allowed to run 30 days past due. The third reference said that he had had accounts amounting to $1,000.00. A lien had to be filed in order to secure collection. This particular reference said that he liked Mr. Jones personally, but that he took a bigger job than he could handle. The bank reference stated that Mr. Jones' account had run as high as $3,500.00, having started with $200.00 and closed with $1,500.00. The local bank reference stated that they knew nothing about him except that he came with a good letter and deposited $1,200.00, which he still had on deposit.

Mr. Jones claims that he owns a small office building in Salt Lake City and has a small income of rent amounting to $350.00 a month from it. He also owns a house and lot in Ogden, Utah, where he formerly lived. His father and mother are still living there. He is married and has one son eight years old. He is renting a five-room house for $75.00 a month and his wife is working in an office to help until they get started in Los Angeles. He plans to do business with the Gregory Brick Company, the Smith Lumber Company and the Globe Cement Company.

1. Would you grant credit on the basis of this information?
2. What additional facts would you like to have before granting the credit?

VI. On September 15, 1924, the buyer of the John Robbins Clothing Company introduced James Jackson to the Assistant Credit Manager, stating that Mr. Jackson was a personal friend of his and, although he had not seen him in eight years, he had reason to believe him of good character and a man who took care of his accounts promptly. In conversation with the prospective customer the credit man received the following information concerning him:

> He had been a resident of Los Angeles for the past month and was expecting to accept a position which was to be open for him in a few days. He had no other retail or wholesale accounts in the city; he had no bank account, but had a certificate of deposit with him for $445.00; he did not own property in Los Angeles. He could furnish A1 credit information from leading stores in Chicago, Philadelphia and New York, where he had been working as a civil engineer for the past ten years.

The Assistant Credit Manager refused credit for the following reasons: "Applicant was not a resident of Los Angeles for one year"; "had no other retail credit in the city"; "was not *working*" (although he had a position available in a few days); "had no bank account," and "owned no property in this vicinity." The Assistant Credit Manager did not consider the character recommendation given by the buyer of the company and the store references. The applicant left the store, when credit was refused, and went to a competitive firm from whom he purchased merchandise to the amount of $245.00 and for which he paid cash.

1. Was the Assistant Credit Manager using good judgment when he refused this applicant credit?

VII. Mr. Joseph Osgood applied for a small line of credit at the Brockman Clothing Company, Denver, Colorado. He filled out the following application blank:

> NAME: Joseph Osgood. MARRIED: Yes. WIFE'S NAME: Frances M. ADDRESS: 500 Herold Way. FORMER ADDRESS: 382 Orbella Ave. HOW LONG IN DENVER: 1 yr. HOW LONG AT PRESENT ADDRESS: 6 m. OCCUPATION: Clerk. EMPLOYER: California Spaghetti Factory. SALARY: .... HOW LONG EMPLOYED IN PRESENT POSITION: 6 mos. BANKING HOUSE: None. OTHER CREDIT ACCOUNTS: None. BOARD OR LIVE AT HOME: Rent apt. OWN YOUR OWN HOME: No. OWN ANY OTHER PROPERTY: No.

AUTHORIZED BUYERS: Wife, elder daughter, Margaret, and myself. REFERENCES: J. C. Smith, Mgr. ADDRESS: California Spaghetti Factory. REMARKS: Wish credit to the amount of $50.00 a month.

In the above application no salary was stated. On calling upon his reference Mr. Smith stated that the man was a good worker and had been working at the factory for about six months, but declined to state the man's salary. This is all the information that could be obtained.

1. Would you grant the man credit? If not, why? If so, how much?

VIII. A factory branch of the Puncture Proof Tire Company is carrying on their books a dealer who has had $3,000.00 worth of tires on consignment since January 1, 1924. This dealer rents his store room, which is located in the center of the automobile business district of the city. He owns his own fixtures, which include a vulcanizing and a repair outfit valued at $1,000.00. He has been in business about nine months, never having been in business before. He has good character references from prominent people in the city, seems energetic and a good mixer and is well liked in the community. Business has been very dull since the first of the year. The dealer's bank balance is very low. He has paid $500.00 of the $3,000.00 consignment, but is unable to pay more, although he has sold over half of the consignment.

The factory branch now receives notice from their head office in the East stating that all consignments must be paid for or else withdrawn by May 1. Just across the street from the dealer in question is an up-to-date tire shop carrying a competitive line of tires.

It is now May 1 and the dealer is unable to meet his payment on the consignment or even pay for the half of the consignment he has sold. He promises to make a substantial payment by July 1.

The Branch Manager now has two alternatives open to him. He may write to the factory in the East asking that this dealer be given an extension of time or he may withdraw the tires on consignment and throw the dealer into bankruptcy.

1. What would you do and why?

IX. In November, 1923, Mr. Ray C. Driscoll called at the credit office of a retail store specializing in the sale of women's ready-to-wear clothing in a city of almost a million people. He applied for credit. He had no other retail accounts and no bank account, but gave two references to wholesalers in the city. He claimed to own an automobile and to be the owner of the Driscoll factory, which he said he had owned for the past seven months. Reliable authorities had no reports on file concerning his standing. Mr. Driscoll was very anxious to open an account immediately in order that his wife might do some purchasing.

In a few days the following report was received: "Worth $1,000 to $2,000 net. Credit limited." A small line of credit was given after Mr. Driscoll had repeatedly called on the telephone. A few days later another report was received as follows:

> Wife claimed to know nothing about his business. Authorities unable to estimate his investment. No bank connections. Formerly an electrical engineer for a street railway. Well regarded personally. No fire record. Resident of the city for some time. Engaged in manufacturing business on small scale.

Credit was extended to Mr. Driscoll, but limited to $75.00.

No payments were made on account. Several letters were written asking for payment and a collector called at Mr. Driscoll's home. He promised to pay in April, but this was not done.

1. Was a basis for retail credit established?
2. What other information should have been secured before granting credit?
3. Write the series of letters which you would have written after credit was granted.
4. What would have been your action beyond that of writing letters and sending out a collector after or prior to October, 1924?

X. Mr. A. G. Stake called at one of the branch warehouses of the Mahogany Furniture Company and purchased a bill of goods amounting to approximately $50.00. It is the custom of this company to allow a first, small order to be taken from their warehouses without the full data being submitted to the main credit department. In other words, the man in charge of the warehouse must satisfy himself as to the reliability of the person making the purchase. The name of the purchaser and any additional information which is obtained is immediately forwarded to the main credit department, where a complete investigation of the account is made and the warehouse notified whether or not to solicit any further business.

If the account in question proved to be satisfactory it was fairly certain that Mr. Stake would do $25,000.00 worth of business in the next six months. Two calls were made on Mr. Stake by the credit department to obtain sufficient information to enable the account to be opened. Neither call was successful, as Mr. Stake was absent both times and no one else could furnish the necessary information. A financial statement form was left with one of his employees to be filled out and returned.

One of the subordinates of the Mahogany Furniture Company intimated that Mr. Stake was being financed by a third party. This was found to be untrue from a telephone conversation with the third party. No references were obtainable, as it seemed that Mr. Stake had not sought credit prior to this time. Information was requested from several other furniture

houses, but only one house knew of him. This firm had not sold merchandise to Mr. Stake, but believed him inexperienced in the furniture line and, furthermore, advised the company to be careful about granting him any credit.

A week passed and Mr. Stake had not called nor had the financial statement been returned. The warehouse had allowed Mr. Stake's employees to take out material which finally brought the account up to about $100.00. They were advised by the credit department not to allow the Stake Company to take any more material until the account had been proved to be a good credit risk.

During the week that passed four or five telephone calls were received at the credit department from personal friends of Mr. Stake advising that he was "good" for any requirements. These people were unknown to the credit department and did not seem to be of very reliable credit standing themselves. Mr. Stake was apparently too busy to call at the credit office personally.

Keeping in mind the possibility of the $25,000.00 business, answer the following questions:

1. How much credit would you extend Mr. Stake before the account was thoroughly investigated?
2. What information would you seek to obtain from Mr. Stake when he called?
3. What would be your decision on the account with the material at hand?
4. Would you make a third attempt to make an appointment with Mr. Stake?

XI. Charles Johnson was formerly a Canadian wheat farmer and owns 1,280 acres in Alberta, Canada, which he leases on crop shares. He has a ten-unit bungalow court in Hollywood, California, from which he derives an income of $250.00 per month. There is a five-year mortgage on this property in the amount of $8,500.00. He recently purchased a sixteen unit apartment which he is to operate himself. There is a $42,000.00 mortgage on this property payable in monthly installments of $495.00 each, including interest. He intends to sell the Hollywood property in order to be free from debt as soon as possible.

A copy of his balance sheet follows:

Assets

Cash in Banks	$ 2,900.00
Unsecured Loans Due	2,000.00
Secured Loans and Mortgage	1,000.00
Total Liquid Assets	$ 5,900.00

Stocks and Bonds	$ 1,000.00
Real Estate and Buildings	130,200.00
Furniture in Bungalow Court	8,000.00
TOTAL	$145,100.00

LIABILITIES

Due Others	$ 2,300.00
Total Current Liabilities	2,300.00
Mortgage on Real Estate	55,500.00
Chattel Mortgage $165 a Month	3,500.00
TOTAL	$ 61,300.00
NET WORTH	83,800.00
	$145,100.00

Information from other banks indicated the man's character to be entirely satisfactory and that his loans have been paid promptly.

Mr. Johnson is seeking a credit of $10,000.00 unsecured.

1. On the strength of the above, do you think it would be advisable to make this loan unsecured?
2. What reasons would you give for a decision either for or against an extension of credit?
3. Is it ordinarily good policy for a man to tie up his assets in such large fixed investments?

The bond for $1,000.00 in the foregoing statement was found to be worthless. The statement shows Chattel Mortgage of $165.00 a month against an income of $250.00 a month. The real estate market in and about Hollywood was not in the most prosperous condition at the time the loan was applied for. The outlook for apartment houses and bungalow courts was not very bright. The applicant has two large properties and not sufficient income to cover the current indebtedness. In view of these facts, the loan was denied.

4. Was the officer justified in denying the loan?

XII. Charles Burton made application at the credit office of a large department store known as B. N. Stone & Company, Buffalo, New York, for a regular open account. On the same day he also purchased goods amounting to $50.00 to be delivered as soon as the charge account was established.

Mr. Burton was formerly employed as a reputable salesman by the

Gray Lamp Shade Company, where he was considered good for a reasonable amount of credit. It was reported that he was a member of the Silk Lamp Shade Company, which started business in March, 1924. This company expects to incorporate soon as a closed corporation consisting of Mr. Burton, his father and two other members. Mr. Burton stated that his investment will be $25,000.00, that he owns no real estate but that he does own patent rights. He gave as references his bank and three personal references. He claims to be the owner and manufacturer of the Silk Lamp Shade Company. When asked if he had accounts at other stores in the city he replied that he did not. A local bank reported that they have a lack of confidence in the subject and expressed the belief that if any credit is extended to him it should be done cautiously. Records dated February 11, 1924, show a chattel mortgage on an automobile for $1,000.00, 6 months, 7%. Five accounts were placed in the hands of collection agencies, which were all paid except one and it was cancelled as uncollectible.

In order to save the sale, the credit department of Stone & Company asked Mr. Burton to come in and told him that it would be impossible for him to open an account with them as he was very slow in paying his bills. He replied that this was not true and was told to go to the Credit Association so that they might correct their report. However, he paid cash for his purchases and did not call at the Association.

1. Was the credit manager justified in denying credit?

XIII. Mr. C. C. Tomlinson, a retail meat dealer in a town of about 15,000 people, has had an account with the First National Bank for seven months. He is applying for a loan of $500.00, and files the following statement:

Assets	
Cash on Hand and in Bank	$ 300.00
Accounts Receivable	75.00
Salable Merchandise	150.00
Total Quick Assets	525.00
Machinery and Tools	2,500.00
Total	$3,025.00
Liabilities	
Open Accounts, Payable @ $75.00 a Month	$1,165.00
Total Liabilities	1,165.00
Net Worth	1,860.00
Total	$3,025.00

His only liability, as indicated, is payable $75.00 a month on his machinery and tools. The machinery company has first claim on his tools inasmuch as they are sold on a conditional sales contract.

1. Should the loan be granted?
2. Would you grant the loan if you could satisfy yourself that the moral risk is good and that the $500.00 was to be used for more merchandise?

XIV. J. A. Arnold bought furniture from the San Antonio Barber Supply Company to equip a three-chair barber shop complete on a conditional sales contract according to regular terms. He paid cash for the opening order of supplies, but requested that he be allowed to establish an account on credit. He has been in San Antonio two weeks, having come from the town of X, Wisconsin, where he claims to have operated a seven-chair barber shop. He offers as references the landlord of the building from whom he leased his shop, the banker from whom he secured loans, and the supply house from which he secured his supplies in X, Wisconsin. He claims a residence in this Wisconsin town of seventeen years.

The credit manager of the San Antonio Barber Supply Company writes to all the references, and in each case the reply comes back, "Do not know this party." Mr. Arnold has now requested an order of supplies, saying in his letter that he has no doubt but that by this time all his references and his recommendations have come in and that credit will be granted.

1. Would you take a chance on filling a small order for him until further information was secured?
2. To what sources would you go for more information regarding this customer?

XV. The statement of the Hard and Warming Coal Company reveals the following:

Current Assets	$ 400,000.00
Current Liabilities	190,000.00
Total Liabilities	443,000.00
Total Assets	2,320,000.00
Net Worth	1,877,000.00

Besides getting the customary credit for merchandise bought, they have a bank loan of $150,000.00. Antecedent and other information is favorable, except that their accounting for income tax has been faulty and they may be called upon to meet an additional tax liability of $350,000.00.

1. Would you still grant them the customary amount of credit if you were a coal operator?
2. Is tax liability sometimes more serious than it would be in this case?

XVI. On September 24, 1923, Mr. E. C. Simmons, one of the officers of the Bowen Canning Company, of Riverbank, California, submitted to a rating agency the following written and signed statement purporting to show the company's condition:

ASSETS

Cash in Bank	$ 2,800.00	
Office Fixtures	600.00	
Accounts Receivable	11,000.00	
Merchandise, Canned Goods	93,000.00	
Raw Material, Boxes and Labels	6,800.00	
Machinery and Fixtures	32,000.00	
Buildings and 2½ Acres Land	34,000.00	
1 Auto Truck	1,200.00	$181,400.00

LIABILITIES

Accounts Payable	$ 3,500.00	
Mortgage on Real Estate	10,000.00	
Borrowed from Banks	52,000.00	65,500.00
NET WORTH		$115,900.00

"None of the above indebtedness is past due. Annual business last year $264,000.00. Carries blanket insurance on merchandise. Insurance on buildings and plant $13,000.00. No fire loss."

(Signed) BOWEN CANNING COMPANY
By: E. C. Simmons

The report from the rating agency was as follows:

"The above statement is believed given in good faith. Cash in bank is confirmed. The real estate is said to include buildings valued at $24,000 and land consisting of 2½ acres valued at $10,000. Accounts receivable may suffer some shrinkage in collection and fixtures would be subject to the usual depreciation.

"After all necessary allowances are made for depreciation, shrinkages, etc., authorities estimate the company's net worth for credit purposes at from $50,000 to $75,000. The company has an authorized capital of $50,000, of which $41,400 is claimed subscribed and paid in at this time.

"TRADE OPINIONS. Investigation has been made, but the account cannot be located in the trade. Their principal purchases are believed made from the farmers, to whom they are said to be paying cash.

"Antecedents. This company was incorporated under California laws with charter dated May 19, 1922. They commenced business at 521 Santa Fe Building, Los Angeles, July 1, 1922, starting new, and continued at that address until some time in 1923, when they moved to their present location.

"James Bowen, President, was formerly employed by Libby, McNeil & Libby, and is said to have been in the canning business for the past thirty years. George Rock, Vice-President, was formerly employed as a mechanic in Riverbank. Harold Osborne, Secretary and Treasurer, was formerly a part owner in the Coastal Lumber Company at Riverbank. Mrs. A. Fairfield, one of the directors, was also connected with the Coastal Lumber Company, and she and Mr. Osborne are said to have cleared $10,000 in about one year in that business. Mrs. Fairfield is estimated to be worth about $30,000 net.

"Fire Record. None so far as known.

"General Remarks: All interested are in good personal standing and those in charge are reported capable and attentive. The premises occupied are a fair-sized one-story corrugated iron building adjoining the Santa Fe tracks in the western limits of Riverbank. Their plant is said to be well arranged. The location is good and they are reported to have done a good business during the past year."

On March 17, 1924, the Bowen Canning Company filed another statement with the rating agency which reads as follows:

"Incorporated May 22, 1922, under California laws, authorized capital stock $25,000, par value of shares $100 each, claiming at the time $18,900 paid in in cash, but to date the entire capital stock fully paid in.

"The records of February 21, 1923, indicate that they filed a certificate to increase the capital stock from $25,000 to $50,000, dated February 20, 1923. Permit for this increase, however, has not as yet been granted.

"On January 28, 1924, a statement signed by E. C. Simmons purporting to be of December 31, 1923, was received through the mail:

Assets		Liabilities	
Mdse. on Hand......	$ 73,541.67	Loans from Bank...	$ 58,665.24
Value of Fixtures...	400.00	Loans from Others .	1,000.00
Accounts Receivable.	10,404.27	Mtge. on R. E......	10,000.00
Cash in Bank........	739.80	Other Obligations....	12,727.08

R. E. and Buildings	$ 45,486.70	Cap. Stock Issued	$ 41,500.00
Other Assets	110.25	Surplus in use as Capital	2,075.00
		Undivided Profits	654.33
		Reserve for Building and Machinery	4,061.04
TOTAL	$130,682.69	TOTAL	$130,682.69

Annual business $128,582.82. Annual expense $52,058.99. Insurance on Merchandise $56,000. Insurance on Buildings $13,000. Carry employer's liability insurance.

"GENERAL INFORMATION. The foregoing figures taken from the company's records are accepted as fair showing of the business condition and self-explanatory. As indicated they carry a heavy indebtedness at bank as in other quarters and indebtedness is believed proportionately large. Those conferred with at this time do not offer any estimates of worth. The company has all along been more or less handicapped by lack of sufficient operating capital and as indicated during 1923 contracted a considerable indebtedness. Although during the past season the concern is understood to have packed about 50,000 cases of tomatoes, this was not sufficiently large output to materially better their condition and, though present statement does not indicate them in a position to expect credit extensions, they have, however, met small current merchandise bills promptly.

"The interested parties are well regarded personally, but the company has operated in the face of somewhat adverse market conditions, keen competition and not a thorough knowledge of this business. At the present time the company is believed too heavily indebted to expect further credit accommodations.

"FIRE RECORD. None."

1. Would you grant $5,000 credit on 60-day terms to this company on April 15, 1924?
2. What does a comparative study of the statements indicate as to credit possibilities?
3. Classify and analyze information given, showing how you came to your conclusions.

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